Final Report of the
Québec Taxation
Review Committee

COMPETITIVENESS
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FOCUSING ON QUÉBEC'S FUTURE

VOLUME 1

Québec Tax Reform

Québec

**Final Report of the
Québec Taxation
Review Committee**

March 2015

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Québec Tax Reform

*Commission
d'examen
sur la fiscalité*
Québec

Final Report of the Québec Taxation Review Committee

FOCUSING ON QUÉBEC'S FUTURE
Volume 1 – Québec Tax Reform

Legal deposit – March 2015
Bibliothèque et Archives nationales du Québec
ISBN 978-2-550-72677-7 (PRINT)
ISBN 978-2-550-72678-4 (PDF)
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COVER LETTER FROM THE COMMITTEE

February 6, 2015

Mr. Carlos Leitão
Minister of Finance
12, rue Saint-Louis, 1er étage
Québec (Québec) G1R 5L3

Dear Minister,

It is with considerable pride that I submit to you, on behalf of the members of the Québec Taxation Review Committee, the report stemming from our deliberations. The unanimous report reflects the efforts of all of the committee members and proposes a major reform of Québec's taxation system.

To carry out the mandate that the government assigned to us, we defined and implemented a demanding, strategic work approach.

Under the approach, the Québec Taxation Review Committee called upon a number of Québec, Canadian and foreign experts, from whom the committee commissioned studies to examine in depth points that we deemed to be essential.

The work approach that we adopted also included extensive public consultations, through which the committee learned of the opinions and proposals of individuals and groups that wished to participate in this extensive reflection.

The report that is being submitted to you is, therefore, the work of a team of experienced committee members but also the outcome of the analyses of individuals and organizations that reflect Québec in all of its breadth and diversity.

Focusing on the future

We have entitled our report *Focusing on Québec's Future*. Indeed, the reform that we are proposing includes numerous facets, all of them centred on Québec's future.

The proposed reform hinges on a basic observation: the government's leeway to reform taxation is limited, because of the heavy tax burden. From the outset, we therefore adopted a demanding guideline, i.e. the definition of tax reform that is neutral from the standpoint of the tax revenues collected.

It is in this framework that we are proposing to the government tax reform that fosters economic growth and enhances Quebecers' standard of living through a reduction of the taxes that are the most harmful to growth, offset by a review of tax expenditures and a new tax mix.

The new tax mix that we are proposing would directly affect economic growth and the standard of living. It would benefit all taxpayers and, in particular, middle-class taxpayers. At the same time, the committee has ensured that the poorest taxpayers are protected.

We are also proposing numerous fiscal enhancements aimed at remedying anomalies or responding to specific challenges. Our reform is very forward-looking and offers suggestions that should sustain reflection in the years ahead.

A reform for all Quebecers

Several principles guided us.

We sought to define an equitable tax reform both for individuals and for businesses. It was important for us to propose a simpler, more transparent, more coherent taxation system that addresses key concerns such as tax competition or the erosion of the tax base.

The reform that we are proposing is adjusted over time. It comprises short-, medium- and long-term initiatives.

All of the recommendations that we are making are aimed at the Québec government, but several of them also call for dialogue with the federal government and other Canadian jurisdictions.

The reform is intended, first and foremost, for all Quebecers, whose well-being and prosperity were at the forefront of our reflections.

Thank you for the confidence that you have displayed in us.

Yours truly,

Luc Godbout

Chair
Québec Taxation Review Committee

Members of the Québec Taxation Review Committee

Dana Ades-Landy

Danièle Milette

Jean Pierre Vidal

Jean-Pierre Vidal

Carole Vincent

Pierre-Carl Michaud

Yves St-Maurice

Luc Villeneuve

ACKNOWLEDGEMENTS

In my capacity as Chair of the Québec Taxation Review Committee, I would like to emphasize the significant contribution made by everyone who supported the committee throughout its deliberations. Without them, this report would not be possible.

To bring to fruition a project of this scope in only eight months required the elaboration of a work plan, which had to rely on outside know-how, public consultations and a competent, totally dedicated team.

I would first like to thank Minister of Finance Carlos Leitão for the confidence that he displayed in us by assigning us this stimulating mandate, one that is important for all Quebecers.

❑ The Québec Taxation Review Committee secretariat

The Québec Taxation Review Committee secretariat played a pivotal role in the smooth progress of our deliberations.

Éric Ducharme, Secretary of the Québec Taxation Review Committee, made an outstanding contribution both through his skills in the realm of government intervention through fiscal policy and through his dedication.

Luc Castonguay, Assistant Secretary, brilliantly coordinated the specific analyses, including the briefs received and studies conducted by the Ministère des Finances du Québec.

Jennifer Dorval rounded out the Secretariat and assumed, with considerable professionalism, the planning of activities in addition to the logistical facets of our deliberations.

❑ The Ministère des Finances

I must once again emphasize the skill of the staff in the Ministère des Finances. The Ministère des Finance's ongoing support enabled the committee to successfully complete different facets of its analytical deliberations. My sincere thanks to Deputy Minister of Finance Luc Monty for his support.

Special thanks go to Assistant Deputy Minister David Bahan, Corporate Tax Policy and Economic Development; Assistant Deputy Minister Simon Bergeron, Budgetary Policy; Assistant Deputy Minister Pierre Côté, Policy respecting Individuals, Federal-Provincial Relations and the Economy; and Assistant Deputy Minister Marc Grandisson, Tax Law and Local and Aboriginal Policies, and to all of their teams.

❑ The public consultations

I would like to acknowledge the individuals and organizations that sustained our deliberations through briefs, comments and discussions. The ideas that we gathered were essential to fully grasp the challenges and expectations surrounding a question as vast and complex as taxation.

In the context of its public consultations, the committee was able to rely on the know-how of the Institut du Nouveau Monde. I would like to thank Michel Venne and his team for their excellent work in the organization and leadership of the citizens' forums in seven regions of Québec.

The 198 briefs received confirm the importance of the public hearings. I would like to thank each of the groups, organizations and individuals who took the trouble to express their concerns and viewpoints. The briefs unquestionably enlightened and sustained the committee's reflections.

The Direction des communications in the Ministère des Finances

Both in the context of its public consultations and its deliberations overall, the committee received support from the staff of the Direction des communications in the Ministère des Finances.

The technical and logistical assistance that Nathalie Foster's team provided enabled the committee to concentrate fully on the crux of its mandate.

External studies

In the course of its deliberations, the committee felt it was important to more thoroughly examine certain topics. It was able to rely on the work of Québec, Canadian and foreign experts. The committee feels privileged to have benefited from so much know-how.

It extends special thanks to independent researchers Stéphane Buydens, Alain Charlet, Bev Dahlby, Ergete Ferede, Jonathan Rhys Kesselman and Jean-François Wen.

Thanks are due, too, to the organizations whose members contributed to our deliberations, i.e. the Agora fiscalité, the Centre interuniversitaire de recherche en analyse des organisations, the Chaire de gestion du secteur de l'énergie, the Research Chair in Taxation and Public Finance, the Industrial Alliance Research Chair on the Economics of Demographic Change, the IMF's Public Finance Department, E&B Data, the Groupe de recherche appliquée en macroécologie, the Institut du Québec, KPMG and Raymond Chabot Grant Thornton.

Drafting of the report

Jean-Pierre Pellegrin and Alexandre Simard from the Ministère du Conseil exécutif, assisted by Claude Bertrand and Anne-Marie Dubocage, wrote the report and committee documents.

I congratulate them for accurately expressing the committee members' ideas and their considerable ability to transform the entire array of information into this voluminous report.

The committee members

To conclude, I would like to thank my fellow committee members, who have supported me in recent months.

Their expertise, knowledge and talent were indeed valuable. Throughout our mandate, they ensured a solid foundation for this major undertaking.

Luc Godbout

Chair

Québec Taxation Review Committee

TABLE OF CONTENTS

Cover letter from the Committee I

Acknowledgements V

Introduction 1

PART 1: CHALLENGES, PRINCIPLES AND OBJECTIVES 13

1. The challenges identified 15
2. The principles adopted 21
3. The objectives adopted 25

PART 2: THE REFORM GEARED TO THE OBJECTIVES ADOPTED 31

1. Foster economic growth and a higher standard of living 33
    - 1.1 A short-term initiative: a reduction of income tax, a review of tax expenditures and a new tax mix 37
        - The proposed reform 38
        - The introduction of the proposed reform: personal income tax 52
        - The introduction of the proposed reform: corporate tax 71
    - 1.2 A medium-term perspective: a review of the taxation of capital gains 90
    - 1.3 Long-term reflection: the examination of a dual income tax system 95
2. Encourage business investment 99
    - 2.1 The revision of certain tax measures 101
    - 2.2 More effective recourse to tax-advantaged funds 111
    - 2.3 Easier business transfers between persons dealing on a non-arm's length basis 117
    - 2.4 A harmonized system for stock options awarded to employees for large businesses 124
3. Encourage labour market participation 129
    - 3.1 Support for and the promotion of the work effort through the "tax shield": the problem of high implicit marginal tax rates 130
    - 3.2 Continued labour market participation or a return by experienced workers to the labour market 132
    - 3.3 Encourage maintenance on or a return to the labour market: the enhancement of the work premium and the modification of the refundable tax credit for child assistance 138
    - 3.4 The federal household income-splitting measure 142

4. Encourage personal savings ... 143
   - 4.1 Make better use of existing tax tools as regards saving ... 144
   - 4.2 Continued support for tax-advantaged funds ... 149
   - 4.3 The replacement of the lifetime capital gains exemption by an additional RRSP contribution ... 150

5. Adhere to sustainable development ... 153
   - 5.1 Increase the additional motor vehicle registration fee demanded on luxury vehicles ... 154
   - 5.2 The increase in the fuel tax on gasoline and diesel ... 155
   - 5.3 The increase in the price of heritage pool electricity within the framework of Hydro-Québec's rating and the levying of a tax on overconsumption of electricity in the household sector ... 157
   - 5.4 Better integration of the principles of eco-taxation ... 163

6. Collect all tax revenues ... 165
   - 6.1 The fight against tax evasion, tax avoidance and aggressive tax planning schemes ... 166
   - 6.2 The collection of sales tax and income tax pertaining to e-commerce ... 178
   - 6.3 Better oversight of provisions respecting trusts ... 188

7. Adapt taxation to a changing society ... 197
   - 7.1 User fees for reduced-contribution childcare services ... 198
   - 7.2 The sound management of tax expenditures ... 202

8. Ensure the equitable redistribution of collective wealth and adequate support for the most disadvantaged ... 207
   - 8.1 The enhancement of the solidarity tax credit ... 208
   - 8.2 Enhanced management of the solidarity tax credit ... 210
   - 8.3 Other proposals of the committee that enhance support for the most disadvantaged ... 212

PART 3: THE REFORM ADJUSTED OVER TIME ... 213

1. The immediate tightening of tax expenditures in order to meet the targets set in Budget 2014-2015 ... 215
   - 1.1 The interim report ... 215
   - 1.2 Recognition by the government of the committee's interim report in the *Update on Québec's Economic and Financial Situation* ... 217

2. A short-, medium- and long-term tax reform ... 219
   - 2.1 In the short term ... 219
   - 2.2 In the medium and long term ... 220

PART 4: AN ESTIMATE OF THE ANTICIPATED IMPACT **221**

1. An estimate of the impact of the reform on individuals 223
    - 1.1 An estimate of the impact of the reform on families 225
    - 1.2 An estimate of the impact of the reform on persons living alone 234
    - 1.3 An estimate of the impact of the reform on childless couples 235
    - 1.4 An estimate of the impact of the reform on seniors 236
2. An estimate of the impact of the reform on corporations. 239

Conclusion **249**

Recommendations **251**

APPENDIX 1: THE QUÉBEC TAXATION REVIEW COMMITTEE **277**

APPENDIX 2: THE COMMITTEE'S PUBLIC CONSULTATIONS **279**

1. Citizens' forums 279
2. Interveners with whom the committee met during the public hearings 281
3. Interveners that submitted briefs 285

APPENDIX 3: THE STUDIES AND THE REPORT UNDERPINNING THE COMMITTEE'S DELIBERATIONS **293**

Charts

CHART 1 Increase in employment resulting from the committee's proposed reform 49

CHART 2 Marginal tax rate (Québec only) according to the proposed and existing tax rate schedules, based on annual taxable income – 2015 58

CHART 3 Corporate income tax rates 72

CHART 4 Marginal tax rate on the income of an SME, except in the manufacturing sector – 2015 76

CHART 5 Marginal tax rate on the income of an SME in the manufacturing sector – 2015 77

CHART 6 Illustration of the tax assistance offered by the premium for experienced workers for an eligible person living alone 60 years of age or over – 2015 133

CHART 7 Structure of the household electricity rate – With the 10% overconsumption tax 160

CHART 8 Revenu Québec tax recovery 167

CHART 9 Tax burden differential – All corporations, 2014 245

CHART 10 Marginal effective tax rates (METR) on capital taking into account the committee's recommendations 247

Tables

TABLE 1 Long-term gain in real GDP per dollar of reduction in the tax burden 44

TABLE 2 Economic impact of the committee's proposed reform – Estimates based on the general equilibrium model of the Ministère des Finances 48

TABLE 3 Changes to the mix of personal taxation methods – Summary 53

TABLE 4 The new proposed personal income tax rate schedule 57

TABLE 5 Changes to the mix of taxation methods of corporations – Summary 71

TABLE 6 Tax payable in the current situation and in the proposed situation, except for the manufacturing sector – 2015 78

TABLE 7 Tax payable in the current situation and in the proposed situation, manufacturing sector – 2015 79

TABLE 8 Comparison of the yield from tax benefits stemming from the purchase of shares in tax-advantaged funds 114

TABLE 9 Direct Canadian investments abroad 172

TABLE 10 Savings and additional revenues generated by the measures that the committee proposed in its interim report 216

TABLE 11 Financial impact of the tax measures to restore budgetary balance from the December 2, 2014 *Update on Québec's Economic and Financial Situation* stemming from the recommendations in the committee's interim report 217

TABLE 12 Change in disposable income for a couple with a 3-year-old child and two equal incomes – without taking into account the proposed changes to the reduced-contribution childcare services rate......................................226

TABLE 13 Change in disposable income for a couple with a 3-year-old child and two equal incomes – taking into account the proposed changes to the reduced-contribution childcare services rate..227

TABLE 14 Change in disposable income for a couple with two children 3 and 4 years of age and two equal incomes – without taking into account the proposed changes to the reduced-contribution childcare services rate 228

TABLE 15 Change in disposable income for a couple with two children 3 and 4 years of age and two equal incomes – taking into account the proposed changes to the reduced-contribution childcare services rate 229

TABLE 16 Change in disposable income for a couple with two children 7 and 9 years of age and two equal incomes..230

TABLE 17 Change in disposable income for a single-parent family with a 3-year-old child – without taking into account the proposed changes to the reduced-contribution childcare services rate 231

TABLE 18 Change in disposable income for a single-parent family with a 3-year-old child – taking into account the proposed changes to the reduced-contribution childcare services rate 232

TABLE 19 Change in the disposable income for a single-parent family with a 7-year-old child 233

TABLE 20 Change in disposable income for a person living alone...............................234

TABLE 21 Change in disposable income for a childless couple 235

TABLE 22 Change in the disposable income of a couple in which both spouses are 60 years of age with equal work incomes 236

TABLE 23 Change in the disposable income of a couple in which both spouses are 65 years of age with equal work incomes 237

TABLE 24 Change in the disposable income of a couple in which both spouses are 65 years of age and only one spouse has pension income 238

TABLE 25 Illustration of the impacts of the committee's recommendations on a large taxable corporation in the processing sector 240

TABLE 26 Illustration of the impacts of the committee's recommendations on a non-taxable corporation in the processing sector 241

TABLE 27 Illustration of the impacts of the committee's recommendations on a small company in the service sector with more than five employees 242

TABLE 28 Illustration of the impacts of the committee's recommendations on a professional practising through a corporation 243

TABLE 29 Marginal effective tax rate on capital in Québec, by sector 247

INTRODUCTION

The government established the Québec Taxation Review Committee in June 2014.[1]

Luc Godbout, Director of the Département de fiscalité at the Université de Sherbrooke, chaired the committee.

The committee comprised:

- Dana Ades-Landy, Vice-President, Bank of Nova Scotia
- Pierre-Carl Michaud, associate professor, Département des sciences économiques, Université du Québec à Montréal
- Danièle Milette, tax expert
- Yves St-Maurice, economist
- Jean-Pierre Vidal, CPA, CA, associate professor, taxation, HEC Montréal
- Luc Villeneuve, FCPA, FCA, Chairman for Québec, Deloitte
- Carole Vincent, economist, consultant and researcher in economic studies

At the conclusion of eight months of deliberations, the Québec Taxation Review Committee is submitting its final report, which comprises a summary and six volumes.

❑ Volume 1

Volume 1, entitled ***Québec Tax Reform,*** presents the contents of the proposed reform.

This initial volume is divided into four parts:

- In Part 1, the committee explains the **challenges, principles and objectives** that guided its reflections.
- Part 2 is devoted to the proposed reform, **which reflects the objectives adopted**.
- Part 3 focuses on the **adjustment over time** of the proposed reform.
- Lastly, in Part 4, the committee provides an **estimate of the anticipated impact.**

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[1] The establishment of the Québec Taxation Review Committee to analyze, and propose the reform of, the Québec taxation system was announced by the Premier in his May 21, 2014 inaugural speech at the opening of the 41st Legislature of the National Assembly, and subsequently confirmed in Budget 2014-2015. The order in council of June 11, 2014 officially created the Québec Taxation Review Committee and stipulated its mandate.

❑ The mandate assigned to the Québec Taxation Review Committee

Before it examines the contents of the reform, the committee would like to review the mandate that the government assigned to it, its understanding of it and the approach that it adopted to carry out the mandate.

The government defined the committee's mandate as follows:

- examine all tax measures from the standpoint of their relevance and efficacy to pinpoint measures to reduce tax expenditures overall in order to comply with the targets set in Budget 2014-2015;
- examine the Québec taxation system to enhance its efficiency, fairness and competitiveness and ensure funding for public services;
- compare international taxation trends, in particular with respect to the practices of proximate neighbours such as the United States and the other Canadian provinces;
- examine the possibility of rethinking balance between different modes of taxation;
- attentively review the business taxation system to propose avenues that will better support economic growth;
- analyze the personal income tax system, in particular to further encourage work and saving and optimize user fees while ensuring fair redistribution of collective wealth through the maintenance of adequate support for the most disadvantaged;
- assess the possibility of subjecting to taxation certain user fees in order to take into account the ability to pay of the users of public services, bearing in mind the impacts on the implicit marginal taxation rates.

Chronologically, the committee responded to the first facet of its mandate, i.e. the identification of measures to ensure compliance with the budgetary targets set,[2] in an interim report submitted to the government on October 31, 2014.[3]

In this final report, the committee is covering all aspects of its mandate.

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[2] The measures should enable the government to achieve $150 million in savings in 2014-2015 and $650 million a year starting in 2015-2016.

[3] The full text of the interim report appears in Volume 4 of this report.

☐ Interpretation of the mandate

Based on the demands that the government formulated, it was essential for the committee to fully grasp its mandate from the outset and to bear in mind a number of priorities throughout its deliberations.

■ Two different themes

The committee had to reflect upon tax reform that would make the Québec taxation system more competitive, more efficient and fairer, in order to better encourage people to work, foster saving, better spur investment and better foster economic growth and enhance the standard of living.

At the same time, the committee had to contribute through its deliberations to a return to a balanced budget by pinpointing immediate tightening of tax expenditures in order to comply with the targets set in Budget 2014-2015.

What is more, given the time frame that the government imposed, the challenge posed was to respond to the second priority in October although the perspective of the reform could only be specified later, when the final report was submitted.

Based on the mandate assigned to it, the committee is thus targeting tax initiatives that fall within the scope of two different themes. There is, of course, an obligation to ensure the coherence of the initiatives proposed under each theme.

- **The first theme**

The first theme that the committee adopted is Québec tax reform that engenders zero cost in the short, medium and long terms for all taxpayers[4] and is neutral as regards public finances.

Tax reform in Québec is the focal point of the committee's mandate. It could be implemented gradually, with short-, medium- and long-term proposals.

The reform would engender zero cost for taxpayers, i.e. both individuals and corporations taken separately. The committee thus imposed on itself a demanding reference point in order to take into account the current level of taxation.

Because of this reference point, the tax reform would be neutral for public finances. It is important to emphasize that the tax reform targeted by the committee is not intended to generate new revenues for the government.

A reform that is neutral for public finances means that the objective of the reform is not to alter the combined weight of taxation and user fees in the economy. Accordingly, the proposed modifications must be self-financing without either further weighing down or streamlining overall taxation.

— The lost government revenues stemming from the proposals would be offset by other measures to increase such revenues by an equivalent amount.

— Conversely, additional tax revenues stemming from the abolition or tightening of certain fiscal measures would reduce other government revenues by an equivalent amount.

- **The second theme**

The second theme stipulated by the government's mandate is the immediate tightening of tax expenditures.

At the same time as a definition of tax reform, the committee received a mandate to pinpoint immediate tightening measures to contribute to attaining budgetary balance according to the targets set in Budget 2014-2015.

The interim report submitted on October 31, 2014 proposed such tightening measures to the government.

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[4] By taxpayers we mean both individuals and corporations.

The scope of the mandate

The mandate that the government assigned to the committee includes a number of reference points that define the scope of its deliberations.

The scope of the mandate encompasses the tax burden of Québec taxpayers, both individuals and corporations.[5]

The proposed reform is based on the taxation system that applies to Québec taxpayers at the time of submission of the report.

The fiscal levies analyzed

The committee was asked to examine the Québec taxation system overall, i.e. all of the provisions found in taxing statutes, including tax expenditures.

From the standpoint of fiscal levies, the committee excluded from its analysis mining duties, in particular to avoid calling into question the stability of the mining regime that has undergone several revisions in recent years.

Moreover, the committee did not examine the question of duties on hydrocarbons (oil and gas) since numerous steps have yet to be completed in Québec before it is possible to rule on the conditions of exploitation of such resources.

User fees for public services

The committee noted that its mandate also called for it to examine questions related to user fees for public services.

The committee was asked to reflect on conceivable options to fund public services by analyzing, in particular, interrelationships between taxation and user fees. It also had to take into account in its analysis the repercussions of user fees for certain target groups, such as the most disadvantaged.

The committee believed that its deliberations must refer to certain fees applied by government corporations, especially because of the possibility of using such fees to fund public services.

However, the committee decided for several reasons not to broach the question of user fees related to health services utilization.

- The matter is extremely complex and raises questions that lie outside the field of fiscal analyses.
- Possible options in the realm of the application of user fees to health services utilization clash with provisions in the *Canada Health Act*.
- This question thus raises factors related to intergovernmental relations and exceeds the mandate assigned by the government.

---

[5] In its report, the committee has used the term "corporation" to designate taxpayers deemed to be corporations from a legal and fiscal standpoint, i.e. taxpayers that form an incorporated entity. The term "enterprise" refers to an organization that engages in an economic activity without necessarily having the legal and fiscal status of a corporation.

The committee also decided not to analyze the question of setting fees for higher education, although funding for higher education poses a major challenge.

- The question of setting fees for higher education has been subject to extensive debate in recent years.
- The government has defined guidelines and the committee felt that it was not useful to reopen the topic.

- **Payroll taxes**

The committee considered the weight of the payroll taxes paid to public plans in its analysis of the income tax position of individuals and enterprises.

However, its mandate did not include the analysis of the relevance or the level of benefits provided by the plans that such contributions fund. Consequently, the committee did not analyze the balance between the benefits and the contributions levied to fund them.

- **Overall fiscal levies collected in Québec's territory**

The proposed reform fits in with the levies collected in Québec's territory not only by the Québec government but also by the federal government, the municipalities and public bodies.

It was essential to take into account this situation in the assessment of the weight of taxation and in the recommendations concerning the reforms to be undertaken. When necessary, the committee therefore emphasized the need to involve the federal government in the implementation of certain of its recommendations.

Furthermore, the existence of tax rules concurrently defined by two levels of government raises the question of harmonization, which seeks to subject a taxpayer to identical or similar Québec and federal tax rules in order to simplify his obligations. The committee examined the question of harmonization when it formulated its recommendations.

It took into account municipal taxation in its analysis, in particular in its evaluation of the overall weight of taxation, without examining the breakdown between the Québec government and the municipalities. In particular, the committee felt that its mandate did not call for it to broach the tax and financial agreements between the Québec government and the municipalities.

- **Interaction between the Québec taxation system and those of the other provinces**

Extensive interaction arises between the Québec taxation system and those of the other provinces because of the common economic space that they share.

For this reason, Québec should discuss certain of the committee's recommendations with other provincial governments.

- **Revenue collection**

The committee examined the methods of collecting tax revenues such as the ones adopted by Revenu Québec.

On the other hand, it did not focus on the efficiency and effectiveness of the agency as a government body as it did not deem this question to fall within the ambit of its mandate.

- **Federal transfers**

The committee excluded from its analysis federal transfers, except for certain interactions that occur between such transfers and the tax provisions examined, in particular the Québec abatement under the personal income tax system.

In this way, the committee did not examine the question of fiscal imbalance.

The committee and program review

The committee wishes to point out that it was not established as a way to avoid program review.

The government undertook a comprehensive collective reflection on the effectiveness of programs and the funding of public services, within the framework of the Ongoing Program Review Committee. Deliberations on taxation must not circumvent program review by focusing, for example, on a heavier tax burden.

The deliberations of the two committees affect the taxation and budgetary sectors, which are sometimes interdependent. When necessary, the committee thus ensured that links were established with the Ongoing Program Review Committee in order to achieve coherence with reflection on both sides.

The overall level of taxation

Except for the tightening measures included in the first section of its mandate, the committee did not have a mandate to review the overall level of taxation, regardless of the impact that a shift from taxation to user fees would have. Instead, it had to review the manner of taxing and the priorities adopted in the examination of tax expenditures.

As we noted earlier, the committee had to thus define tax reform that is neutral from the standpoint of public finances and the modifications proposed must be self-financing and neither increase nor decrease the overall tax burden.

An overall decrease in the tax burden can only be contemplated after budget surpluses have been achieved and insofar as the budgetary balance thus attained is deemed to be solid and durable. Once budgetary balance has been restored, the government has committed itself to devoting half of the surpluses available to reducing the tax burden.

The committee did not receive a mandate to identify for what purposes the possible surpluses would be earmarked. However, it believes that were the government to achieve such surpluses and it wished to partly use them to lower the tax burden, such reductions should be along the same lines as the proposed tax reform.

☐ The approach adopted

Based on the mandate assigned to it, the committee focused on three sources of reflection:

- the briefs, comments and suggestions submitted or formulated during the public consultations;[6]
- external studies commissioned from Québec, Canadian and foreign experts on topics that the committee wished to examine in greater depth;[7]
- the analyses and studies conducted at its request by the committee secretariat and which mainly came from the Ministère des Finances du Québec.

■ The public consultations

The public consultations were a significant component of the committee's deliberations.

In September 2014, three documents were produced at the committee's request to enable individuals and groups wishing to participate in the consultations to prepare themselves. The documents sought to provide:

- an overview of the Québec taxation system;
- key relevant information on Québec's personal income tax system;
- key relevant information on Québec's corporate taxation system.

The documents presented an array of information and data and thus shed light in a simple, comprehensive manner on the Québec taxation system, thereby facilitating reflection by the participants in the public consultations.

The committee launched a call for briefs in September 2014. It received 198 briefs, which it examined.

The committee invited nearly half of the individuals, groups or organizations that submitted a brief to present their analyses and recommendations at public meetings held in Montréal and in Québec City.

It mandated the Institut du Nouveau Monde to organize citizens' forums, which were held on September 29 and October 9, 2014 in seven regions of Québec. Some 225 individuals spoke in the presence of certain committee members.

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[6] Appendix 2 of this volume provides a full list of the briefs submitted.

[7] Appendix 3 of this volume provides a full list of the studies.

The committee's public consultations

The committee's consultations

All told, the committee received 198 briefs.

Public meetings were held in Montréal from October 20 to 23, 2014, and in Québec City from October 28 to 30, 2014.

The committee met with 82 individuals, groups or organizations during the meetings.

A half day of private meetings was also held in Montréal on October 24, 2014, during which the committee met with six groups, at the latters' request.[1]

The citizens' forums organized by the Institut du Nouveau Monde

Citizens' forums were organized in Lévis, Sherbrooke, Montréal, Gatineau, Rouyn-Noranda, Saguenay, and Rimouski between September 29 and October 9, 2014.

All told, 225 participants expressed themselves at the citizens' forums.

The contents of the discussions and proposals

Volume 6 of this report is devoted exclusively to the committee's public consultations. It includes a report from the Institut du Nouveau Monde to the committee on the exchanges that took place at the citizens' forums and all of the briefs received.

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[1] A public version of the briefs presented at that time appears in Volume 6 of this report, which inventories all of the briefs received.

❑ The announcement of the plan of the reports

At the conclusion of its deliberations, the committee submitted to the government its final report, *Focusing on Québec's Future*, which comprises a summary and six volumes.

The summary, entitled ***The Reform in Brief***, identifies the strong points of the tax reform proposed to the government.

Volume 1, ***Québec Tax Reform***, presents the contents of the proposed reform. It examines in turn the challenges, principles and objectives that guided the committee, the key characteristics of the reform, its adjustment over time and an estimate of the anticipated impact.

Volume 2, ***A Reform of All Methods of Taxation***, provides details of the proposals by method of taxation.

Volume 3, ***Status Report***, presents an analysis of the main characteristics of the Québec taxation system from various angles. The analysis led the committee to pinpoint the proposed reform.

Volume 4, ***Documents Submitted During the Mandate***, includes the interim report submitted on October 31, 2014 and *Excerpt from the Final Report: Funding of Reduced-Contribution Childcare Services* submitted on a preliminary basis to the Minister of Finance at his request on November 18, 2014.

Volume 5, ***Studies to Support the Committee's Deliberations***, comprises the 17 studies that the committee commissioned from experts and organizations.

Volume 6, ***The Public Consultations***, assembles both the report produced by the Institut du Nouveau Monde the reports to the committee the contents of the exchanges that took place within the framework of the citizens' forums and all of the 198 briefs received.

PART 1:
CHALLENGES, PRINCIPLES AND OBJECTIVES

It was essential for the committee to base its reflection on a solid foundation.

The committee therefore reflected on the challenges, principles and objectives that would guide it in the elaboration of tax reform.

- The challenges stem directly from the committee's understanding of Québec's economic, demographic, social and fiscal context.
- The committee adopted nine principles that directly draw inspiration from the principles usually adopted to evaluate tax systems and adapted them to specific problems found in Québec.
- It then adopted eight objectives that the tax reform pursues. The objectives stem from the mandate that the government assigned to the committee.

1. THE CHALLENGES IDENTIFIED

Based on an analysis of the context of Québec's economic, demographic, social and fiscal environment, the committee identified four key challenges that must be considered in the tax reform.

1.1 Economic growth and the enhancement of the standard of living against a backdrop of demographic changes

The first challenge, which the government evoked when it established the Québec Taxation Review Committee, concerns Québec's economic growth and its medium- and long-term development.

In the budget document made public in June 2014,[8] the government emphasized Québec's dampened economic growth, which directly affects government revenues and Quebecers' standard of living.

— For the period 2000-2008, average annual growth in Québec's real GDP stood at 2.1%.

— Since 2011, economic growth has only averaged 1.5% per year.

This relatively weak growth is attributable both to cyclical factors (essentially the fragility of the world economy) and to structural factors, i.e. demographic changes and weak potential growth among Québec's key economic partners.[9]

From the standpoint of demographic changes, the ageing of the population will reduce the number of potential workers in the coming years. Accordingly, Ministère des Finances and private sector projections suggest that economic growth will remain sluggish. Consequently, growth in the standard of living measured by per capita GDP will also be more modest than it has been in the past.

This first challenge means that we must reflect on how we can use taxation to counteract the impact of trends that affect economic growth and an increase in the standard of living.

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[8] Ministère des Finances du Québec, Budget 2014-2015 – The Challenge of Québec's Public Finances, [document], June 2014.

[9] For additional information, see Part 4 of Volume 3 of this report.

1.2 Public finances

Québec has struggled to return to a balanced budget since the last crisis. Since 2009, it has been grappling with budgetary deficits, which have persisted year after year. The 2013-2014 deficit was of the same magnitude as that observed in 2009-2010 at the height of the world economic crisis, although the government introduced measures that led to an annual increase in its revenues of more than $6 billion.

The persistent budget deficit is affecting Québec's indebtedness.

- As at March 31, 2014, Québec's gross-debt-to-GDP ratio stood at 54.3%, compared with 45.0% in Ontario and 39.4% in Nova Scotia.
- In 2013-2014, the government allocated $10.6 billion to debt service, equivalent to 11.2% of its expenditures.

The persistent deficit and heavy indebtedness are limiting the government's ability to fund public services. The restoration of balanced public finances and the long-term maintenance of such balance are, accordingly, a priority for the government.

The committee's mandate falls within the scope of this priority. It seeks to pinpoint:

- immediate tightening measures, which are covered by the interim report, aimed at restoring budgetary balance in 2015-2016;
- initiatives to ensure solid prosperity through taxation that fosters economic growth, and provides an incentive to work, save and invest in the short, medium and long terms.

1.3 The competitiveness of the taxation system and the erosion of the tax base

Tax competitiveness is twofold:

- overall tax competitiveness in relation to other jurisdictions;
- sectoral competitiveness in fields in which Québec firms are competing with businesses in other jurisdictions.

An analysis of tax competitiveness leads to two observations:

- Québec's already heavy tax burden is limiting the leeway available to carry out the reform;
- such leeway is also limited by certain factors that are exacerbating the erosion of the tax base.

☐ A component of costs and, therefore, a factor in the decision to invest

Both in global and sectoral terms, taxation is a component of costs and, therefore, affects the decision to invest. The tax burden that a business must bear alters the profitability of a project or an investment. All things being otherwise equal, when a company compares different jurisdictions, it is to its advantage to choose the jurisdiction with the lowest tax expense or offering the best tax incentives.

However, taxation is not the only factor that influences economic decisions. Manpower costs, rents and transportation also enter into investment decisions. Other considerations such as the availability and qualification of manpower and political or economic stability are also important.

☐ Québec's already heavy tax burden is limiting the leeway available to carry out the reform

The weight of taxation in the Québec economy is significant. The ratio between tax revenues and GDP observed in Québec is higher than the average for the G7 countries and the member nations of the Organisation for Economic Co-operation and Development (OECD).[10]

Furthermore, Québec relies on all methods of taxation. Personal income tax accounts for 13.0% of Québec's GDP, one of the highest proportions in relation to the OECD countries.

Québec's taxation is higher than that applied by its main North American trading partners as regards personal income tax, corporate income tax, consumption taxes, payroll taxes, and wealth taxes. Electricity rates are the only important field in which levies in Québec are lower than in neighbouring jurisdictions.

This phenomenon singularly limits the latitude available to change the tax structure at zero cost, i.e. without having an impact on public finances.

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[10] For additional information, see Part 3 of Volume 3 of this report.

☐ The erosion of the tax base

The erosion of the tax base is increasingly limiting Québec's fiscal leeway.

The committee has identified two major challenges.

■ E-commerce

The rapid development of Internet communications has made possible e-commerce, which is revolutionizing transaction methods the world over.

The growth in e-commerce is posing a major challenge, i.e. the collection of the taxes applicable to such activities. Taxation authorities are having considerable difficulty applying taxation rules to electronic trade transactions when such transactions are performed by a supplier outside the territory that the authorities control.

■ Tax evasion and tax avoidance

Tax evasion and tax avoidance[11] are not new. Some taxpayers have always sought to avoid their tax liabilities through fraudulent behaviour or by taking advantage of certain loopholes in the applicable legislation and regulations.

Tax evasion and tax avoidance have taken on a new dimension with the globalization of trade, which, through the new information and communications technologies, has led to increased circulation of capital. Capital has never been so mobile, which has altered the scope of the tax evasion and tax avoidance strategies of businesses and individuals.

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[11] See page 166 for a definition of the concepts of tax evasion and tax avoidance.

1.4 The attainment of certain social objectives

Québec society seeks to be a just society. The Québec taxation system must not undermine this aspiration.

Taxation is, in a proactive manner, an essential tool available to the government to help build a fairer society. Two social objectives, in particular, are targeted:

- the fight against poverty and social exclusion;
- the attainment of greater gender equality.

❑ The fight against poverty and social exclusion

From the standpoint of the fight against poverty and social exclusion, the committee supports the government's initiatives over more than a decade.

In 2002, the National Assembly of Québec unanimously adopted the *Act to combat poverty and social exclusion*. Québec was the first jurisdiction in North America to adopt such a statute and made the fight against poverty a government priority.

The Act seeks to "build a better Québec in which every person has a rightful place, can live with dignity, and can take an active part in society and can contribute to its development to the extent of his or her abilities."[12]

Among other things, the Act commits the government to implement specific action plans and institutional structures to ensure follow-up to the plans.

In the elaboration of its recommendations, the committee acknowledges the importance of pursuing the government's initiatives to combat poverty and social exclusion.

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[12] Ministère de l'Emploi et de la Solidarité sociale, *The Will to Act, The Strength to Succeed: National Strategy to Combat Poverty and Social Exclusion* [policy statement], June 2002, page 9.

☐ Gender equality

As for gender equality, the committee supports the government's policy directions in this respect.

In 2006, the Québec government established a gender equality policy entitled *Pour que l'égalité de droit devienne une égalité de fait.* This major policy associates all government departments and bodies with the promotion of gender equality in various sectors and different respects.

Gender equality action plans have accompanied the policy since it was launched in 2006.

Seven key directions structure government initiatives to promote gender equality, including economic equality between women and men.

The promotion of economic gender equality focuses on:

- initiatives to foster the diversification and status of the educational choices of girls and women in occupations that offer the best employment prospects;
- the labour market integration and continued employment of women;
- employment equity for women and a reduction of pay inequities;
- support for women entrepreneurs;
- the enhancement of women's lifelong economic security.

In its analysis and in the elaboration of its recommendations, the committee focused on gender equality even though it did not systematically conduct gender-differentiated analyses.

The committee recognizes that it is important for the government to continue to support economic equality between women and men in the elaboration of its fiscal policy and, in particular, access by women to the labour market and their continued employment.

2. THE PRINCIPLES ADOPTED

A series of principles underpins the committee's elaboration of its proposals.

The principles correspond to features that the Québec taxation system should observe. They reflect the priorities that we must bear in mind when we contemplate the tax system and tax reform.

The principles are not independent of each other. They are often complementary or interrelated.

The application of the principles may demand arbitration. When they are implemented, several principles may indeed conflict. We must bear in mind this situation and evaluate the application of the principles overall.

The committee presents below the nine principles that it adopted.

2.1 A systemic approach

Taxation encompasses an array of provisions that belong to a comprehensive system that satisfies a logic and in which numerous interrelationships come into play.

The definition of the tax rules must stem coherently from the characteristics of the system into which the rules are integrated.

The tax system must be evaluated as a whole. An evaluation of the tax system must focus on the entire system and not on any one of its provisions. For example, the committee believes that an assessment of the progressivity of the tax system requires a systemic approach.

2.2 Fairness

Fairness is, for some observers, the foundation of an adequate fiscal policy. In this perspective, a tax system must fairly distribute the tax burden among taxpayers.

Fairness is often analyzed from the standpoint of vertical equity and horizontal equity.

☐ Vertical equity

Vertical equity means that a taxpayer's tax burden increases with his ability to pay.

It underpins the progressivity of the tax system. Progressivity originates in the hypothesis that the marginal utility of revenue apparently decreases. Through progressivity, we seek to apply a comparable sacrifice to low-, middle- and high-income taxpayers.

☐ Horizontal equity

Horizontal equity means that taxpayers who are deemed to have comparable life situations must be subject to equivalent tax expenses.

☐ The application of principles of equity

The application of the principles of vertical and horizontal equity hinges largely on what is deemed to be an adequate measurement of a taxpayer's "ability to pay."

An individual's ability to pay depends, of course, on his income, but also on his family status, e.g. an individual living alone or as part of a couple with or without children, and the essential needs that the person must cover.

However, the assessment to determine whether two individuals are "in comparable situations" and the tax system is "sufficiently progressive" is basically subjective.

The principle of equity must be applied bearing in mind the impact that such an application might have, particularly on the incentive to work.

2.3 Neutrality

A tax system must not create a financial distortion in the choice of resource allocation to avoid distorting the economic decisions of agents. The principle of neutrality thus incorporates the notion of economic efficiency.

In principle, in a free market economy and in the absence of market failures, resources are allocated efficiently. In point of fact, resources are not always allocated efficiently.

Despite this reservation, the tax system is deemed to be better when it is more neutral, i.e. when it minimizes distortions in respect of economic decisions.

In fact, the principle of neutrality is far from being fully observed. States frequently use fiscal policy to modify the allocation of resources in the economy. Such initiatives break the principle of neutrality.

To do so is warranted if the deviations correspond to clearly enunciated public policy objectives such as environmental protection, the encouragement of saving, or support for research and development.

Recognition of this principle means that the distortions stemming from the tax system must, however, be minimized.

2.4 Simplicity

Simplicity makes methods of taxation and tax measures clear and easier to understand for taxpayers and all citizens.

It enhances the transparency of the tax system. Simplicity helps to minimize management and compliance costs, i.e. the costs necessary to abide by the tax rules.

Widespread reliance on preferential tax measures runs counter to the principle of simplicity.

2.5 Transparency

The principle of transparency means that everyone must perceive and understand the rationale for tax measures and their contents.

It also applies to the beneficiaries of tax provisions. Everyone must also readily perceive the beneficiaries of tax measures and the nature of the benefits.

2.6 Predictability

Both the State and economic agents emphasize predictability in tax matters.

For the State, predictability means that the tax system must produce revenue whose scope and development can reasonably be anticipated in the future. Predictability is essential to define the budget framework in the coming years.

In the case of economic agents—both individuals and corporations—the tax rules must be predictable to allow the agents to carry out reliable financial planning and make economic decisions based on accurate information on the future cost of tax. Predictability is an especially crucial factor in investment decisions.

The principle of predictability echoes the principle of transparency as regards the need to ascertain the true impact of current and future tax measures.

On the other hand, predictability does not mean that the taxation system must be absolutely stable. It is normal, and even desirable, for the taxation system to be regularly reassessed and called into question. However, the modifications made to it must not be too frequent. The changes must, above all, be planned as far as possible to avoid introducing a feeling of uncertainty among economic agents.

2.7 The minimization of costs

This principle applies to the cost of collecting tax and the cost of compliance with tax rules.

We must minimize the costs stemming from the implementation of taxation. The State benefits from a reduction in the costs incurred to manage the tax system.

We must also reduce the time required for taxpayers to comply with tax rules.

2.8 Diversity

Balance must be struck in the methods of taxation and setting fees to avoid overdependence on one or more methods of taxation.

This principle must acknowledge that certain methods of taxation more significantly affect economic prosperity and demand that the system is competitive in relation to neighbouring ones.

2.9 Compliance

Taxpayers must comply with the tax rules defined.

The application of this principle therefore implies the fight against tax evasion and the adoption of measures to combat tax avoidance.[13]

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[13] The common definitions of tax evasion and tax avoidance are presented in Section 6.1 on page 166.

3. THE OBJECTIVES ADOPTED

Based on the mandate that the government assigned to it, its interpretation of the challenges raised and the principles adopted, the committee has formulated eight objectives that the tax reform should target.

The first three objectives pertain to wealth creation.

The remaining five objectives that the committee adopted target more specific aims.

3.1 Foster economic growth and a higher standard of living

The first objective, **to foster economic growth and a higher standard of living**, is the very focal point of the mandate that the government assigned to the committee.

Taxation is a powerful tool in the government's hands to promote wealth creation.

The State's choice of different methods of taxation affects economic growth and, therefore, collective wealth. The personal income tax system and the corporate taxation system directly affect the behaviour of economic agents, which necessarily affects wealth creation.

The first objective that the committee has adopted is, therefore, to reform the Québec taxation so that it more broadly fosters economic growth.

3.2 Encourage business investment

The second objective, **to encourage business investment**, logically stems from the first objective and acts upon one of the sections of the committee's mandate.

The government asked the committee to "attentively review the business taxation system to propose avenues that will better support economic growth."

Businesses contribute to creating wealth and growth through their investments. While taxation is not the only determinant that affects investment decisions, it is nonetheless an ideal tool to foster business investment.

The taxation system's competitiveness, another challenge that the committee has pinpointed and that the government has emphasized in its mandate, means precisely that the Québec taxation system must compare favourably with the tax regimes of our key economic partners in the creation of conditions conducive to business investment.

3.3 Encourage labour market participation

The third objective is also related to economic growth and the standard of living, but targets individuals, i.e. **to encourage labour market participation**, through taxation that rewards effort and promotes individual initiatives to integrate into and remain on the labour market.

In the mandate that it assigned to the committee, the government explicitly mentions an analysis of the taxation system in order to more broadly encourage labour market participation.

The government also asked the committee to take into account in its proposals the impact on implicit marginal tax rates, again with a view to promoting labour market participation and avoiding tax measures likely to discourage it.

The work incentive is especially important in the current context of demographic changes. Québec's population is ageing rapidly, which is directly affecting economic growth, because of changes in the labour force. The ageing of the population and the reduction in the working-age labour force characterize the context in which the challenge must be met of economic growth and wealth creation.

It is crucial for Québec to mobilize the means at its disposal, including taxation, to offset the decline in the potential labour pool and nevertheless increase the labour force.

3.4 Encourage personal savings

As the mandate that the government defined indicates, the taxation system must **encourage personal savings**.

Personal savings target several objectives. Individuals must save to contend with unforeseen circumstances, finance major projects such as home ownership or paying for their children's education, prepare adequately for retirement and, generally speaking, ensure sound management of their personal finances. Such objectives are demanding and personal savings must be sufficient to satisfy them.

In a context where responsibility for such challenges is falling increasingly on the individual, the level of personal savings might be regarded as insufficient in some instances, especially to finance retirement.

Taxation directly affects the choice that individuals make between immediate consumption or savings in anticipation of future consumption. Certain tax measures are designed to enhance the return on savings in order to encourage individuals to save.

The Québec taxation system must, accordingly, include the most appropriate measures to contribute to and encourage personal savings.

3.5 Adhere to sustainable development

The committee believes that it goes without saying that tax reform must **adhere to sustainable development**.

The mandate that the government assigned to the committee does not explicitly mention sustainable development, a worldwide challenge that concerns Québec and all jurisdictions. Sustainable development must permeate all public policies. There is a broad consensus on this question in Québec.

The attendant concerns must, therefore, be incorporated into the tax reform. Its impact on economic players makes taxation a key means of better internalizing environmental facets that promote the sustainable development of the economic, social and environmental dimensions of our society.

With this objective, the committee is clearly announcing its intention to propose coherent tax reform that demands sustainable development.

3.6 Collect all tax revenues

The tax reform must enable the State to **collect all tax revenues.**

Capital has never been so mobile and the tax avoidance, tax evasion and aggressive tax planning strategies implemented by corporations and individuals have reached a new scale.

E-commerce is growing extremely rapidly and is raising the question of the collection of the consumption taxes and income tax related to such commerce.

We are witnessing a genuine erosion of the tax base, which is affecting Québec and all jurisdictions.

It must be added that the citizens of the developed countries are increasingly reluctant to bear a high tax burden when certain taxpayers succeed in partly avoiding taxes.

The tax reform must be contemplated in this context. What is more, it must answer the questions raised with regard to public finances: the erosion of the tax base that we are witnessing directly affects the State's ability to fund public services.

3.7 Adapt taxation to a changing society

The tax reform must allow us to **adapt taxation to a changing society**.

Québec society is experiencing numerous, rapid changes.

The demographic changes now under way are directly affecting economic growth because of their impact on the size of the labour force. The same demographic changes have also affected demand for public services.

The objective adopted means that we must reform taxation to adapt to such changes how we fund public service and thereby ensure the sustainability of such funding.

3.8 Ensure the equitable redistribution of collective wealth and adequate support for the most disadvantaged

The last objective that the committee has adopted is drawn directly from the mandate that the government assigned to it: in its analyses and reflections, the committee must seek **to ensure the equitable redistribution of collective wealth and adequate support for the most disadvantaged**.

This objective must be regarded as a condition for the implementation of the preceding objectives. The initiatives proposed in respect of the tax reform must not call into question the equitable redistribution of collective wealth and, particularly, the maintenance of adequate support for the most disadvantaged.

In its precise formulation, the mandate infers that the equitable distribution of wealth is achieved by maintaining support for the most disadvantaged. The committee has preferred to broaden the objective to be attained by targeting both the equitable redistribution of wealth and adequate support for the most disadvantaged.

PART 2:
THE REFORM GEARED TO THE OBJECTIVES ADOPTED

The tax reform that the committee is proposing seeks to achieve the eight objectives adopted.

We will broach the facets of the reform in light of each of the eight corresponding objectives:

- foster economic growth and a higher standard of living;
- encourage business investment;
- encourage labour market participation;
- encourage personal savings;
- adhere to sustainable development;
- collect all tax revenues;
- adapt taxation to a changing society;
- ensure the equitable redistribution of collective wealth and adequate support for the most disadvantaged.

1. FOSTER ECONOMIC GROWTH AND A HIGHER STANDARD OF LIVING

The committee's first objective is to **foster economic growth and a higher standard of living**. This objective is the very focal point of the mandate that the government assigned to the it. Taxation is a powerful tool in the government's hands to promote wealth creation.

❑ A major tax reform

To achieve this first objective, the committee is, therefore, proposing that Québec undertake a major tax reform, to be defined in three stages that correspond to different time frames.

Recommendation 1

To foster economic growth and a higher standard of living, the committee is recommending that Québec undertake a major tax reform comprising three stages, each one corresponding to different time frames.

— In the **first stage**, in the short term, the committee recommends that the government lay the foundations of a tax regime more conducive to economic growth by **reducing** personal income tax, corporate income tax and the payroll tax **for the benefit of all taxpayers.** The reduction would be funded through **a reduction in tax expenditures** and **an adjustment of the methods of taxation**.

— In the **second stage**, in the medium term, the committee recommends that the government undertake **a review of the method of taxation in respect of capital gains** in order to define more coherent taxation.

— In the **third stage**, in the long term, the committee recommends that **thorough reflection occur on the very foundations of income tax** by **examining the implementation of a dual income tax system**.

■ First stage: a reduction in income tax

In the **first stage**, in the short term, the committee recommends that the government **reduce** personal income tax, corporate income tax and the payroll tax **for the benefit of all taxpayers.**

The reduction would first be funded through a **reduction in tax expenditures** based on the principle of a lower rate applied to a broader tax base.

It would also, in the short term, be funded through a change in the relative weight of different methods of taxation, including user fees, which is called the **mixing of methods of taxation**, by defining a new mix more conducive to growth. The committee therefore recommends reduced reliance on certain methods of taxation and broader reliance on the others.

The new tax mix would be accompanied by the enhancement of support measures in favour of the most disadvantaged.

Québec could rapidly implement the reform without calling into question the very foundations of our taxation system.

■ Second stage: a review of the method of taxation in respect of capital gains

In the **second stage**, in the medium term, the committee recommends that the government undertake **a review of the method of taxation in respect of capital gains**.

The review would call into question the specific treatment accorded capital gains both for individuals and corporations in the form of what is called "partial inclusion" but taking fuller account of inflation.

The review would lead to the modification of the current rules that allow for the non-taxation of capital gains on the principal residence. It would include a proposal aimed at transforming the cumulative capital gains exemption[14] into an additional RRSP contribution. It would also lead to changes in the tax treatment of stock options granted to employees.

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[14] The exemption is called the capital gains deduction on qualified property.

■ Third stage: thorough reflection on the very foundations of income tax

In the **third stage**, in the long term, the committee recommends that **thorough reflection occur on the very foundations of income tax** by **examining the implementation of a dual income tax system**.

The current personal income tax and corporate income tax systems hinge essentially on ideas developed in the 1960s.

The economic setting and knowledge of tax-related questions have changed vastly since then. In particular, we now have a much deeper understanding of the impact of methods of taxation and improper resource allocation that each method of taxation can engender.

The committee believes that the time has come to initiate thorough reflection on the relevance of maintaining the current paradigm or gradually shifting to a new income tax system.

▪ A dual income tax system

The committee is proposing the examination of what it regards as a promising avenue—the **implementation, in the long run, of a dual income tax system**—similar to the one that prevails with some success in the Scandinavian countries.

The dual income tax system consists in applying a progressive, relatively high tax scale on work income and a single, low rate on capital income and corporate income, combined with the broadening of the tax base.

The Scandinavian countries have adopted such a system to promote investment, foster growth and thus support a higher standard of living.

The tax reform that the committee is proposing may mark the first step toward such a system without necessarily confining Québec to this path. Additional deliberations will obviously be necessary to ascertain the impact of the implementation in Québec of a dual income tax system.

Such reflection should be carried out in collaboration with the federal and provincial governments.

The committee is explaining in greater detail the contents of the tax reform aimed at promoting economic growth and a higher standard of living by successively broaching each of the three stages proposed:

- a short-term initiative: a reduction of income tax, a review of tax expenditures and a new tax mix;
- a medium-term perspective: a review of the taxation of capital gains;
- long-term reflection: the examination of a dual income tax system.

1.1 A short-term initiative: a reduction of income tax, a review of tax expenditures and a new tax mix

The first stage of the proposed reform will occur in the short term: the committee is proposing a reduction in income tax, a review of tax expenditures and a new tax mix.

— The committee is first outlining the highlights of the proposed reform.

— It then examines in greater detail the implementation of the proposed reform from the standpoint of personal income tax.

— Lastly, the committee specifies the implementation of the proposed reform with respect to corporate tax.

☐ The proposed reform

■ The committee's observations

The proposed reform stems from the committee's observations concerning the personal income tax system and the corporate income tax system.

▪ The personal income tax system

The Québec personal income tax system, in addition to the federal taxation system, is characterized by:

- significant recourse to income tax with fairly high tax rates;
- numerous fiscal measures or tax expenditures, in particular deductions and tax credits.

Funding for services relies less on consumption taxes and to a limited extent on user fees.

Such choices have consequences.

The heavy taxation of income adversely affects economic growth. The proliferation of tax measures reduces the taxation system's transparency by affecting an understanding of it. The use of targeted tax measures runs counter to the principle of neutrality that would instead demand that exceptions be limited. The large number of preferential tax measures also goes against the principle of simplicity.

- **The corporate income tax system**

The Québec and federal corporate taxation systems are characterized by:

— recourse to a considerable number of tax measures;

— the use of targeted tax measures;

— the definition of refundable tax measures, i.e. measures from which corporations benefit even if they have no tax payable.

This observation is similar to the one made concerning individuals and engenders comparable consequences.

Extensive reliance on tax measures affects the taxation system's transparency. Recourse to targeted measures also deviates from the principle of neutrality. To achieve greater neutrality, preference should be given to a taxation system with a broader tax base and a lower general tax rate rather than a system with numerous exceptions and high general tax rates. Such recourse runs counter to the principle of simplicity.

- ***Additional difficulties***

In the specific case of corporations, this diagnosis engenders additional difficulties.

Over the years, changes reduce the stability of the corporate income tax system, which affects corporate investment decisions and, in turn, the system's competitiveness. Under the current system, Québec's corporate taxation system is competitive in certain niches because of targeted measures. To fund targeted measures, more cumbersome and, therefore, less competitive general taxation must be applied to all corporations. What is more, payroll taxes further reduce the competitiveness of the Québec taxation system.

In addition, mention should be made of two reflections stemming from the observation of the current income tax position.

— It is harder to eliminate existing measures than to introduce new ones.

— To respond to a major problem such as the productivity of businesses or their growth, major measures must be adopted. We must avoid spreading measures too thinly.

- **Direct implications for economic growth and the standard of living**

Based on these observations, the committee wishes to emphasize that the choice of methods of taxation has direct implications for economic growth and a higher standard of living.

All fiscal levies aimed at individuals and at corporations have a cost in terms of growth in economic activity and the enhancement of the standard of living.

To contribute to economic growth and a higher standard of living, we must, therefore, give priority to the methods of taxation that are the least detrimental to growth and to a higher standard of living.

▪ The adjustment of methods of taxation to reduce personal income tax, corporate income tax and the payroll tax

These observations lead the committee to propose a reduction in personal income tax, corporate income tax and the payroll tax for the benefit of all taxpayers.

The reduction would be funded by:

— the revision of tax expenditures;

— a new tax mix, including user fees.

▪ The reduction of personal income tax, corporate income tax and the payroll tax

Recommendation 2

The committee recommends the adjustment of methods of taxation leading to a **$5.9-billion** annual reduction in personal income tax, corporate income tax and the payroll tax:

— a **$4.4-billion** reduction in personal income tax;

— a **$1.1-billion** reduction in corporate income tax;

— a **$430-million** reduction in the payroll tax.

▪ The revision of tax expenditures

Recommendation 3

The committee recommends that the reduction in personal income tax, corporate income tax and the payroll tax be funded, first, through the revision of tax expenditures and the elimination or tightening of a number of them.

— The reduction in personal income tax would be funded through the revision of tax expenditures applicable to individuals and the revision of tax expenditures pertaining to consumption taxes.

— The reduction in corporate income tax and the payroll tax would be funded through a revision of the tax expenditures applicable to corporations.

The committee conducted a systematic examination of all of the tax expenditures defined in the Québec taxation system that benefit individuals and corporations.[15]

On the basis of the examination, the committee recommends that several tax measures be eliminated and that others be tightened.

▪ *Problems stemming from tax expenditures*

Tax expenditures reduce the tax yield and impose a bigger tax burden on all taxpayers. The reduction lowers the revenues collected and implies, all things being otherwise equal, the application of higher rates.

The measures cause distortions in economic decision-making. They are an obstacle to the sound allocation of resources and hamper growth. Interaction between tax measures can also impede the incentive to work and to save.

Moreover, the presence of numerous tax expenditures complicates the tax system.

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[15] The first three parts of Volume 2 of this report present in detail the findings of the analysis.

- ***Tax expenditures are sometimes inefficient***

Tax expenditures are sometimes inefficient from the standpoint of the objectives that they seek to attain.

- Some measures are too restricted to have a genuine impact on the behaviour of taxpayers.
- Certain measures are used, above all, by a very limited number of taxpayers, some of whom may benefit from expert advice.
- In the case of personal income tax, the taxpayers thus favoured are often those with the highest incomes.
- In the case of corporate tax, certain sectors enjoy a clear advantage over others.
- In certain sectors, the amounts of the reductions of tax payable are significant and are sometimes concentrated among a very small number of beneficiaries.

The reduction in tax expenditures that the committee is proposing would facilitate the implementation of a taxation system that relies on a broader tax base.

These observations lead the committee to propose a reduction in personal income tax, corporate income tax and the payroll tax for the benefit of all taxpayers.

The reduction would have a zero cost for public finances.

- **A new tax mix**

Recommendation 4

The committee recommends that the reduction in personal income tax, corporate income tax and the payroll tax also be funded through a new tax mix.

The committee adopted the following guidelines with respect to the methods of taxation:

— shift part of the personal income tax burden to consumption taxes and user fees, bearing in mind, however, that income tax must predominate;

— consider in the choice of methods of taxation the need to ensure competitive taxation;

— define the choices within the personal income tax system and the corporate income tax system.

Accordingly, the committee recommends avoiding choices that lead to the transfer of the tax burden between corporations and individuals.

- ***The impact of methods of taxation on economic growth***

Extensive investigations have been conducted in recent years in the developed countries to analyze the impact of different methods of taxation on economic growth.

Generally speaking, the studies reveal that direct taxes are more detrimental than indirect taxes.

The committee wanted to pursue the matter further by asking the Ministère des Finances to quantify by means of its economic simulation tools the impact of different methods of taxation on economic growth.

At the committee's request, the simulations took into account user fees, considered in some cases to be an alternative to taxes to fund public services.

- ***Outcomes***

The quantification consisted in simulating a $1-billion increase or reduction in capital taxes, corporate income tax, personal income tax, payroll taxes, consumption taxes and user fees.

Whether the tax burden is increased or decreased, the outcomes respecting the impact on economic growth are similar and lead to a clear division into two groups of different methods of taxation according to their impact on an increase in GDP.

— An increase in capital taxes, corporate income tax and personal income tax especially undermines growth. A reduction has a positive impact on growth.

— On the other hand, a change in consumption taxes or user fees has a much more limited impact on economic growth. An increase in taxes or user fees hampers growth less than an equivalent increase in other forms of levies. Their reduction fosters growth less than a similar reduction in other taxes.

TABLE 1

Long-term gain in real GDP per dollar of reduction in the tax burden
($)

On capital[1]	1.37
On personal income	0.72
On corporate income	0.60
On total payroll[2]	0.55
On the Québec sales tax	0.43
On user fees	0.41

Note: The impact consists in an $11-billion tax reduction or increase in subsidies. The government's loss of revenue is offset through a fixed levy that has a neutral impact on the results.
(1) **The capital tax was abolished on January 1, 2011 and its impact at the time it was still levied is presented here for illustrative purposes.**
(2) **The impact of the tax reduction applied solely to the private sector.**
Source: The calculable general equilibrium model of the Ministère des Finances du Québec.

We can also classify methods of taxation according to their impact on growth.

— Capital taxes are especially harmful to corporations. They have, for that matter, been abolished both in Québec and in Canada.

— Next, corporate income tax and the payroll taxes have a more or less equivalent negative impact.

— Among individuals, income tax impedes growth more than consumption taxes.

This ranking of taxes according to the extent of the distortions that they engender reflects the findings of other studies. This is true, in particular, of the findings of Jean-François Wen, Bev Dahlby and Ergete Ferede in a study that the committee commissioned.[16]

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[16] The authors provide detailed estimates of the marginal cost of public funds, i.e. the loss that society sustains when a government collects an additional dollar of revenue from a given tax source. See Jean-François Wen, Bev Dahlby and Ergete Ferede, *Les implications des distorsions fiscales sur la réforme fiscale au Québec*, November 24, 2014, in Volume 5 of this report.

The capital tax and the contribution of financial institutions

In the December 2014 *Update on Québec's Economic and Financial Situation*, the government announced the implementation of a temporary surtax on financial institutions. The surtax applies to the wages paid by the financial institutions, as does the temporary contribution of financial institutions announced in *Budget 2013-2014*. It will be in force until March 31, 2017.

Some interveners instead proposed reintroducing the capital tax for financial institutions. The committee believes that the reintroduction of the capital tax would raise several questions and that the government should not act upon this proposal.

Impact on financial operations in Québec

The capital tax for all Québec businesses, including financial institutions, was eliminated on January 1, 2011, which reduced the tax burden on investment in order to encourage higher productivity and enhance the Québec taxation system's competitiveness.

Like Québec, Ontario and British Columbia also eliminated the capital tax applicable to financial institutions. Most financial operations in Canada are conducted in the three provinces.

In this context, the committee believes that the risk of shifting the tax base would be particularly high if Québec alone applied such a tax among the provinces in which most financial operations are conducted.

Indeed, the capital and the taxable income of financial institutions can more readily be transferred to another province than other bases such as wages paid.

The levying by Québec alone of a capital tax could thus lead to the transfer to other provinces of financial operations and adversely affect the economy.

Risk of reimbursement of federal compensation

Furthermore, under the 2007 budget, the federal government established financial compensation for the provinces that eliminated their capital tax prior to January 1, 2011.

The restoration of a capital tax on financial institutions would create the risk that Québec would have to reimburse the financial compensation that it has received from the federal government.

An increase in the contribution by financial institutions

Despite the elimination of the capital tax on all corporations, the tax burden of financial institutions and insurance corporations has increased since 2006 because of certain government measures:

- an increase in the general tax rate since 2006, from 8.9% to 11.9%;
- the elimination of QST refunds on the purchases of financial institutions;
- the increase since January 1, 2013 in the contribution of financial institutions.

Accordingly, it is estimated that the tax burden in 2015 of financial institutions and insurance corporations will be nearly $800 million higher than it would have been under the tax system in 2006.

- ***Other considerations***

The committee wishes to round out these findings with four additional considerations.

— Certain methods of levying taxes engender distortions in the behaviour of individuals, in particular as regards labour force participation. Such distortions must be recognized when methods of taxation are chosen.

— Certain taxation options may not produce the anticipated revenue if account has not been taken of tax avoidance. The transfer of corporate income to other provinces is an example of the questions that must not be underestimated when methods of taxation are compared.

— User fees have been incorporated into the discussion concerning the choice of methods of taxation. The importance accorded user fees directly affects the funding anticipated from taxes. When users fees are applicable and desirable, they achieve greater economic efficiency by sending a price signal to users.

— The choice between methods of taxation must take into account the principle of diversity mentioned earlier. It would be inappropriate to select only one method of taxation based on the principle that it is less harmful for the economy. In any tax base, there is a limit to what can be obtained, in particular to remain competitive in relation to neighbouring jurisdictions, limit market distortions and strike a balance between the principles that underpin fiscal policy.

The reform in the short term

At the conclusion of the analyses presented, the committee is, accordingly, formulating in the short term the following proposals.

For individuals

The reform consists in:

- revising the tax rate schedule to **reduce the income tax burden**;
- **enhancing some tax expenditures or defining new ones** to encourage broader labour force participation and maintain experienced workers in employment;
- **abolishing or lowering certain tax expenditures**;
- **increasing recourse to consumption taxes and user fees**;
- **protecting the most disadvantaged** through **the enhancement of support measures** aimed at them.

For corporations

The reform consists in:

- **reducing the general tax rate**;
- **implementing a "growth premium" for small and medium-sized enterprises (SMEs)**;
- **reducing the payroll tax rate for SMEs**;
- **revising the tax expenditures from which corporations benefit** by enhancing in a targeted manner some of them but by abolishing or reducing several others;
- **relying more extensively on user fees**.

The impact of the reform on economic growth and the standard of living

The committee had assessed the impact of the proposed reform on economic growth and on Quebecers' standard of living. Such impact would be significant.

It is difficult to make such estimates but the use of different models enables us to gauge the extent of such impact.

According to the general equilibrium model of the Ministère des Finances

The committee asked the Ministère des Finances to use its general equilibrium model to simulate the short-term economic impact of the proposed reform, i.e. a **$5.9-billion adjustment** in the methods of taxation.

According to the Ministère des Finances evaluation, the committee's proposed reform would increase GDP by **$2 billion** and personal disposable income by **$600 million**.

TABLE 2

Economic impact of the committee's proposed reform – Estimates based on the general equilibrium model of the Ministère des Finances
(in millions of 2013 dollars, unless otherwise indicated)

	Impact of the proposed new tax mix
Cost of the reform for the government	0
Impact on GDP	1 924
Impact on disposable income	592
Impact on private non-residential investment	584
Impact on employment (number)	20 505

Source: The calculable general equilibrium model of the Ministère des Finances du Québec.

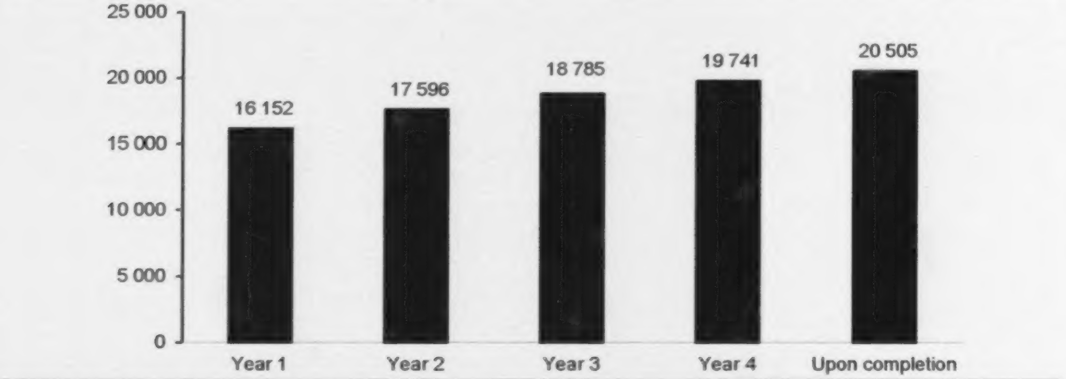
- **Impact on employment**

The reform would, in the long run, support the creation of **20 505 jobs**.

Based on the guidelines that the committee adopted, the reform would have a zero cost for the government.

CHART 1

Increase in employment resulting from the committee's proposed reform
(number)



Source: The calculable general equilibrium model of the Ministère des Finances du Québec.

A more significant impact than a $1-billion tax reduction

The reform that the committee is proposing, including a new tax mix, is neutral with respect to public finances in that it does not engender any cost for the government.

The reform would, nevertheless, have a positive impact on economic growth and the standard of living, as it would on investment and employment, through the efficiency gains achieved by using methods of taxation that are less detrimental to the economy.

The comparison carried out

For illustrative purposes, the committee asked the Ministère des Finances to compare the impact of the proposed reform and of a $1-billion tax reduction on economic growth and the standard of living.

The comparison conducted shows that the zero cost reform that the committee is proposing would have greater economic impact than a $1-billion tax reduction both on growth in GDP and on investment and employment.

On the other hand, a $1-billion tax cut would more significantly affect disposable income, since under such a scenarios the overall tax burden would decrease, which is not the case with the proposed reform at zero cost.

In the simulation carried out, the $1-billion tax reduction would be funded through hypothetical budget surpluses from an undefined source.

If the tax cut hinged on a reduction in public expenditures, the impact on GDP, investment and employment would be reduced, which would further widen the gap observed in favour of the reform that the committee is proposing.

Economic impact of the committee's proposed reform – Estimates based on the general equilibrium model of the Ministère des Finances

(in millions of 2013 dollars, unless otherwise indicated)

	Impact of the proposed new tax mix	Impact of a $1-billion tax cut
Cost of the reform for the government	0	1 000
Impact on GDP	1 924	1 429
Impact on disposable income	592	1 298
Impact on private non-residential investment	584	233
Impact on employment (number)	20 505	17 257

Source: The calculable general equilibrium model of the Ministère des Finances du Québec.

- **Impact of the reform not considered by the general equilibrium model of the Ministère des Finances**

It should be noted that because of the methodology used, the general equilibrium model of the ministère des Finances could not take into account the impact of several specific measures included in the proposed reform.

For example, the committee is proposing the implementation of a "tax shield" and a premium for experienced workers in order to encourage labour market participation. The measures would have an impact on employment that the general equilibrium model cannot grasp.

- **Another evaluation: the impact on the standard of living**

The committee used another methodology designed to dynamically factor in macroeconomic impacts.[17]

The authors evaluated the impact of the tax mix on the standard of living based on the experience of 21 OECD countries over a period of 34 years. The findings suggest that the 1% increase in the consumption tax burden in tax revenues leads ultimately to a 0.25% to 1% increase in the standard of living as measured by per capita GDP.

In light of the calculations stemming from this methodology, the reform could lead to a 1.2% to 4.6% increase in the standard of living.

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[17] Jens Matthias Arnold *et al.*, "Tax Policy for Economic Recovery and Growth" in *The Economic Journal*, February 2011, pages F59-F80.

❑ The introduction of the proposed reform: personal income tax

In practical terms and in the short term, the committee's proposed tax reform would necessitate several major modifications to the personal income tax system.

To foster economic growth and a higher standard of living, the committee is proposing a revision of the current personal income tax schedule that would result in a **$4.4 billion** tax reduction.

— The health contribution would be abolished.

— The basic personal amount would be increased.

— Income tax would be generally reduced and tax brackets would be added in order to enhance the system's progressivity.

— The maximum marginal tax rate, including federal taxation, would not exceed 50%.

This significant reduction in personal income tax would be funded by means of:

— a revision of tax expenditures that would achieve more than **$1.0 billion** in net savings;

The committee is proposing an overall reduction in tax expenditures accompanied by the enhancement of a limited number of tax measures that satisfy the objectives adopted.

— a revision of the existing mix of methods of personal taxation of nearly **$3.7 billion**.

The committee is proposing broader recourse to consumption taxes of nearly **$2.9 billion**.

The committee is also proposing broader reliance on user fees, which will generate **$806 million**.

The most disadvantaged would be protected from the impact of broader reliance on consumption taxes and user fees. To this end, the committee is proposing to earmark **$310 million** to fund the appropriate measures.

All told, the foregoing modifications to the personal income tax system would have a zero cost for taxpayers. The overall tax burden of individuals would neither increase nor decrease.

TABLE 3

Changes to the mix of personal taxation methods – Summary

(millions of dollars)

	Cost for the government
A reduction in personal income tax	**4 372**
– Elimination of the healthcare contribution	734
– Increase in the basic personal amount	225
– A general reduction in personal income tax combined with a more progressive tax schedule	3 413
A revision of tax expenditures related to personal income tax	**(1 010)**
– Enhancement or new tax expenditures that satisfy the objectives set by the committee	538
– A reduction in other tax expenditures	(1 548)
Broader recourse to consumption taxes	**(2 866)**
– An increase in tax rates	(2 665)
– Broadening of the tax base (reduction in tax expenditures)	(201)
Broader recourse to user fees	**(806)**
– Electricity (Hydro-Québec)	(705)
– Childcare services	(101)
Enhancement of support measures for the most disadvantaged	**310**
TOTAL	**0**

Note: The totals may not correspond to the sum of the components because of rounding off.

The reduction in personal income tax

The committee recommends a significant reduction in personal income tax to be achieved by eliminating the healthcare contribution, increasing the basic personal amount and generally reducing personal income tax, combined with a more progressive tax schedule and by ensuring that the maximum marginal tax rate does not exceed 50%.

Elimination of the healthcare contribution

Recommendation 5

The committee recommends the elimination of the healthcare contribution, which would remove the inconsistencies observed in the marginal tax rates under the current system.

The abolition of the healthcare contribution alone would represent a **$734-million** personal income tax reduction.

It is difficult to justify this specific tax given that the healthcare contribution is neither indexed to the cost of health services nor determined by the use of services.

Furthermore, the application of the healthcare contribution in addition to the general tax rate schedule engenders inconsistencies in total taxation.

- **Increase in the basic personal amount**

Recommendation 6

The committee recommends that the basic personal amount be increased to $18 000.

The increase would benefit all taxable taxpayers and represent for them an annual gain of **$225 million**.

- ***Protect from tax the first dollars of income earned***

The basic personal amount better takes into account the ability to pay and consists in protecting from tax the first dollars of income earned.

To this end, the existing taxation system grants a basic tax credit calculated by applying to a basic personal amount a rate of 20%, which is the rate applicable to the second taxable income bracket in the current tax rate schedule.

The committee is proposing that the basic personal amount be raised to $18 000. The increase in the basic personal amount that the committee is recommending would raise from $14 281 to $18 000 the threshold below which a taxpayer does not pay tax.[18]

By contrast, the Centre d'étude sur la pauvreté et l'exclusion estimated in 2013 at $17 000 the low-income cutoff for a person living alone, according to the Market Basket Measure.[19]

- ***A measure that benefits all taxable taxpayers***

The basic personal amount applies to all taxpayer regardless of income. All taxable taxpayers would, therefore, benefit from the proposed increase in the basic personal amount.

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[18] The amount of $14 281 is obtained by multiplying the current basic personal amount of $11 425 by a factor of 1.25—20% divided by 16%—to take into account that the rate applicable to the basic personal amount is 20% while that of the first taxable income bracket in the current tax rate schedule is 16%. The rate applicable to the new basic personal amount would be that of the first rate on the proposed tax rate schedule, i.e. 13%.

[19] Centre d'étude sur la pauvreté et l'exclusion, *La pauvreté, les inégalités et l'exclusion sociale au Québec : état de situation 2013*, Gouvernement du Québec, 2014, page 9.

- **A general reduction in income tax, combined with a more progressive tax rate schedule**

Recommendation 7

The committee recommends a general reduction in income tax, combined with a more progressive tax rate schedule.

The committee recommends that the number of brackets in the Québec tax rate schedule be increased to enhance the progressivity of personal income tax.

The number of rates in the tax rate schedule would increase from four to nine.

— Lower marginal rates would be reduced.

— The upper marginal rate would remain unchanged at 25.75% but would apply to a higher income.

The changes would represent an overall personal income tax cut of **$3.4 billion**.

During the public consultations, several interveners requested that the number of rates in the tax table be increased and that the progressivity of the tax rate schedule be enhanced.

The committee recommends doing so.

- **A maximum marginal tax rate of 50%**

Recommendation 8

The committee recommends that the maximum marginal tax rate of the personal income tax rate schedule, including federal taxation, not exceed 50%.

A high marginal tax rate influences the decision to work. Indeed, the higher the rate is, the less incentive there is to work.

Instead of proposing a maximum marginal tax rate higher than 50%, the committee has preferred to reduce the tax measures that often benefit the well-to-do. By limiting the application of a maximum marginal tax rate of 50%, we will ensure that taxpayers keep at least half of their additional income.

Recent studies[20] show that taxpayers who fall into the upper brackets of the tax rate schedule are highly sensitive to changes in the marginal tax rate. Estimates of the high sensitivity of taxable income suggests that by increasing the marginal tax rate beyond the 50% threshold, tax revenues could in fact decrease instead of increasing, as one would expect them to.

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[20] See Kevin Milligan and Michael Smart, "Taxation and Top Incomes in Canada", NBER Working Paper No. 20489, September 2014, and Emmanuel Saez, Joel Slemrod and Seth H. Giertz, "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review" in *Journal of Economic Literature*, Vol. 50(1), March 2012, pages 3-50.

- **A comparison of the proposed and existing tax rate schedules**

The tax rate schedule that the committee is proposing would lead to a **$3.4-billion** income tax cut.

The proposed tax rate schedule would reach its maximum rate at higher levels of income than the current schedule, i.e. at $150 000 instead of $102 040. The tax rate schedule would comprise nine rates instead of four as is now the case.

- ***A more progressive tax rate schedule***

The main rate reductions would occur in the lowest brackets of the tax rate schedule. The proposed schedule would be more progressive that the existing one.

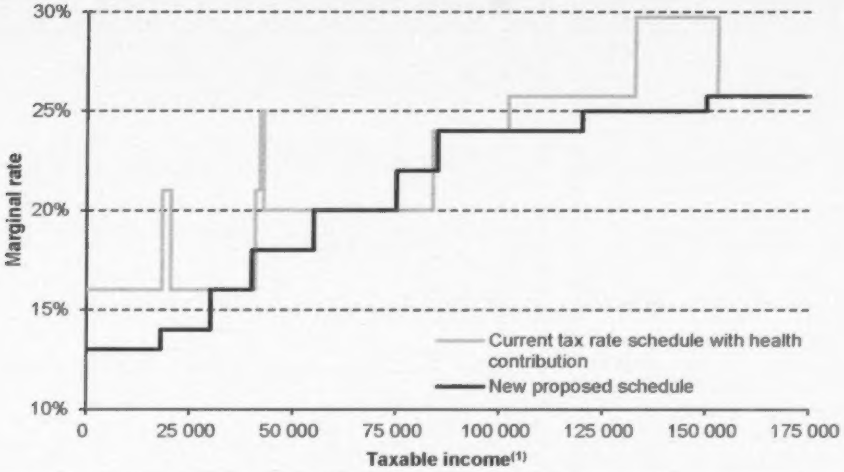
TABLE 4

The new proposed personal income tax rate schedule
(marginal tax rate)

Current tax rate schedule (without the healthcare contribution)		Proposed tax rate schedule	
Less than $41 935:	16%	Less than $18 000:	13%
		$18 000 to $30 000:	14%
		$30 000 to $40 000:	16%
$41 935 to $83 865:	20%	$40 000 to $55 000:	18%
		$55 000 to $75 000:	20%
$83 865 to $102 040:	24%	$75 000 to $85 000:	22%
$102 040 or more:	25.75%	$85 000 to $120 000:	24%
		$120 000 to $150 000:	25%
		$150 000 or more:	25.75%

CHART 2

Marginal tax rate (Québec only) according to the proposed and existing tax rate schedules, based on annual taxable income – 2015
(percentage rate and taxable income in dollars)



Note: Does not take into account the basic personal amount.
(1) When the taxpayer does not benefit from additional deductions on net income.

The current tax rate schedule and the healthcare contribution

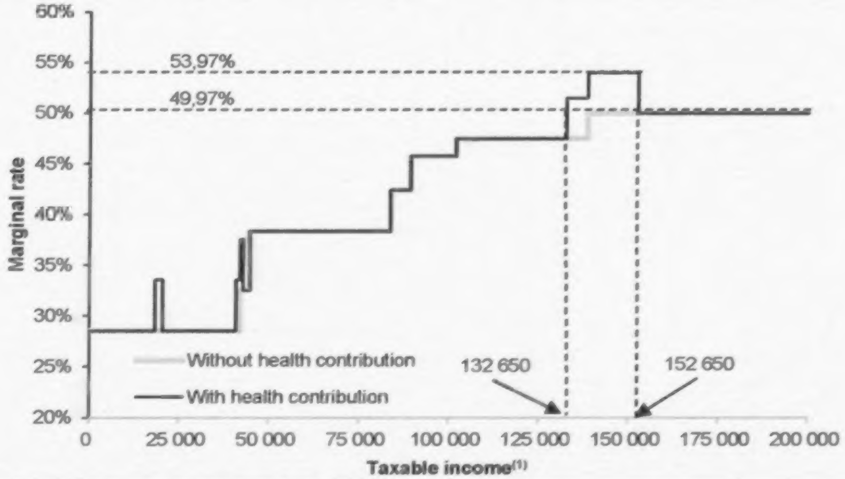
The tax rate schedule

The current Québec tax rate schedule comprises four rates. The maximum marginal tax rate stands at 25.75% for income over $102 040. When federal income tax with a maximum marginal tax rate of 24.22%[1] on income of $138 586 or more is added, the combined maximum marginal tax rate is roughly 50% (49.97%).

The addition of the healthcare contribution

To the tax rate schedule must be added the healthcare contribution in the form of a progressive levy geared to income but that does not follow the tax rate schedule. Beyond an income of $132 650, the contribution increases gradually from $200 to $1 000 on an income of $152 650, then reaches a ceiling at that amount. When the healthcare contribution is combined with the general tax rate schedule, the marginal rate can reach 54% between $138 586 and $152 650, then fall to 50% when the maximum healthcare contribution is reached.

Marginal tax rate (Québec and federal) including the healthcare contribution, based on annual taxable income – 2015
(percentage rate and taxable income in dollars)



Note: Does not take into account the basic personal amount.
(1) When the taxpayer does not benefit from additional deductions on net income.

Integration into the tax rate schedule

The committee believes that it is more transparent and coherent to directly integrate the healthcare contribution into the tax rate schedule.

In January 2013, part of the healthcare contribution was integrated into the tax rate schedule when the contribution was modified to make it more progressive. Indeed, the maximum marginal tax rate then increased from 24% to 25.75%, which made it possible to recover nearly 40% of the amount of the healthcare contribution before its modification.

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[1] Effective rate in Québec after the tax abatement.

■ Funding the reduction in personal income tax

Recommendation 9

The committee recommends that the significant reduction in personal income tax be funded by means of:

- a revision of tax expenditures that would achieve more than **$1.010 billion** in net savings;
  - The committee is proposing an overall reduction in tax expenditures accompanied by the enhancement of a limited number of tax measures that satisfy the objectives adopted.
- broader recourse to consumption taxes, namely:
  - an increase in the rates that would generate **$2.665 billion** in additional tax revenues;
  - a revision of tax expenditures related to consumption taxes, representing savings of **$201 million**;
- additional reliance on user fees, namely:
  - **$101 million** in additional savings through the taxation of reduced-contribution childcare rates;
  - an increase in the price of heritage pool electricity and a new tax on the overconsumption of electricity in the household sector, thereby generating **$705 million**.

A revision of tax expenditures related to personal income tax

The committee recommends that the significant reduction in personal income tax be partly funded by means of a revision of tax expenditures leading to net savings of more than **$1.0 billion**.

The committee is proposing an overall reduction in tax expenditures accompanied by the enhancement of a limited number of tax measures that satisfy the objectives adopted.

In accordance with the mandate that the government assigned to it, the committee undertook a systematic, thorough examination of the tax expenditures related to personal income tax. The examination revealed a number of tightening measures or existing measures to be abolished.

Volume 2 of the report indicates the approach that the committee adopted and its conclusions in respect of existing tax expenditures.

Three tax measures to bolster the work incentive

Moreover, the committee adopted three tax measures whose implementation it recommends to bolster the work incentive.

The work incentive is one of the objectives that the committee has pinpointed in its proposed tax reform. As indicated below, the committee focused its analysis specifically on:

- the problem posed by high implicit marginal tax rates and its impact on labour force participation;
- continued labour market participation or a return by experienced workers to the labour market.

The committee is proposing to enhance the work premium in order to bolster the work incentive for everyone.[21]

What is more, the committee is proposing the creation of a premium for experienced workers to offer a significant incentive for such workers to remain on or return to the labour market.[22]

Lastly, the committee is proposing the creation of a "tax shield" aimed at supporting and encouraging the work effort by reducing the implicit marginal tax rate linked to an annual increase in work income.[23]

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[21] See page 138.

[22] See page 132.

[23] See page 130.

A revision of tax expenditures related to personal income tax

The tax expenditures whose abolition the committee recommends

- Tax credit for volunteer firefighters
- Non-taxation of certain amounts paid to emergency services volunteers
- Deduction for a home relocation loan
- Deduction for moving expenses
- Tax credit for youth activities
- Québec education savings incentive
- Measures to encourage the use of public transit - Non-taxation of benefits granted to employees
- Deduction for foreign farm workers
- Refundable tax credit for seniors' activities
- Refundable tax credit for top-level athletes
- Amateur athlete trusts
- Depreciation of works of art by a Canadian artist
- Refundable tax credit for respite expenses of informal caregivers
- Refundable tax credit for volunteer respite services
- Deduction for workers
- Deduction for employment out of Canada
- Deduction in respect of a foreign worker holding a key position in a foreign production
- Tax holiday for Québec seamen
- Income averaging for artists
- Deduction for an artist regarding copyright or similar royalties
- Tax credit for contributions to a political party
- Deduction for the residence of members of a religious order
- Deduction respecting gifts of securities and gifts of securities acquired under a stock option
- Additional deductions for flow-through shares
- Deduction for certain flow-through share issue expenses
- Additional capital gains exemption in respect of certain resource properties
- Non-taxation of death benefits up to $10 000
- Tax credit for experienced workers
- Tax credit for retirement income
- Tax holiday for foreign professors
- Tax holiday for foreign researchers
- Tax holiday for foreign experts
- Tax holiday for foreign specialists employed by a new financial services corporation
- Tax holiday for foreign post-doctoral interns

A revision of tax expenditures related to personal income tax (continued)

The tax expenditures whose modification the committee recommends

- Deduction for inhabitants of a remote region
- Deduction for members of the Canadian Forces and police officers on deployment
- Deduction of the financial assistance granted to pay tuition fees related to basic training for adults
- Deduction for tradepersons' tool expenses
- Deduction for tool expenses of apprentice vehicle mechanics
- Deduction for goods and services to support a disabled person
- Non-taxation of allowances paid to certain public officers
- Tax exemptions regarding bursaries and awards
- Tax credit respecting the essential needs of minor children engaged in vocational training or post-secondary studies
- Tax credit respecting the essential needs of other dependants
- Transfer of the recognized parental contribution
- Tax credit for tuition fees and examination fees, and possible transfer of unused portion
- Tax credit for persons with a severe and prolonged impairment in mental or physical functions
- Transfer of non-refundable tax credits not used by a spouse
- Tax credit for new graduates working in a remote resource region
- Tax credit for interest paid on student loans
- Refundable tax credit for adoption expenses
- Refundable tax credit for childcare expenses
- Tax credit for gifts
- Non-taxation of certain non-monetary benefits relating to an employment
- Refundable tax credit for home support for seniors
- Refundable tax credit for the acquisition or rental of property intended to help seniors live independently longer
- Refundable tax credit in respect of costs incurred by seniors for a stay in a functional rehabilitation transition unit
- Retirement income splitting between spouses
- Tax credit with respect to age
- Expenses incurred to earn investment income

Broader recourse to consumption taxes

The significant reduction in personal income tax would be funded principally by means of a revision of the existing personal taxation mix.

The revision would imply broader reliance on consumption taxes in the amount of nearly **$2.9 billion**, namely:

— an increase in the rates that would generate **$2.665 billion** in additional tax revenues;

— a revision of tax expenditures related to consumption taxes, representing savings of **$201 million**.

- **An increase in the rate of certain taxes**

The committee is proposing an increase in the rate of certain taxes.

Its proposals concern, for a start, the QST and the tax on insurance premiums.

Recommendation 10

The committee recommends a 1.025-percentage-point increase in the rate of the QST, from 9.975% to 11%. Combined with the GST, the rate would rise from 14.975% to 16%.

The increase would generate **$1.294 billion** in revenue.

In Québec, insurance premiums are not subject to the QST but to the tax on insurance premiums at the rate of 9%.

Recommendation 11

The committee recommends that the rate of the tax on insurance premiums be harmonized with that of the QST and be set at 11%. Personal insurance premiums that are now exempt would continue to be so.

The increase would generate **$391 million** in revenue.

The specific tax on tobacco products and the specific tax on alcoholic beverages would be increased gradually.

Recommendation 12

The committee recommends that the rate of the specific tax on tobacco products be increased in a predictable manner by $1 per year per carton for five years.

In the long run, the increase would generate **$160 million** in revenue.

Recommendation 13

The committee recommends that the tax on alcoholic beverages be increased by an additional $0.078 per litre of beer each year for five years, thereby ultimately generating annual revenues of **$210 million**.

In keeping with the objective that the committee adopted to abide by the principle of sustainable development, certain green taxes would also be increased.[24]

Recommendation 14

The committee recommends that the fuel tax on gasoline and diesel be increased by 1 cent per litre per year for five years to send a clear signal to promote reduced consumption and to give taxpayers time to adapt.

The proposal would ultimately generate **$600 million** in tax revenues annually.

This would complement the anticipated impact of the application of the GHG emission cap-and-trade system.

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[24] See page 153.

Recommendation 15

The committee recommends that the additional registration fee applied to luxury vehicles of more than $50 000 be increased and adjusted.

Accordingly, the rate, which is now 1% of the value that exceeds $40 000 of a vehicle would:

— remain at 1% on the portion of the value exceeding $40 00 up to a maximum of $50 000;

— rise to 2% on the portion of the value exceeding $50 000 up to a maximum of $60 000;

— would rise to 3% on the portion of the value exceeding $60 000.

The committee also recommends that electric vehicles no longer be subject to the additional fees in order to recognize their environmental benefits.

The proposal would generate **$11 million** in tax revenues annually.

All told, the higher rates would generate **$2.665 billion** in additional tax revenues.

- **A revision of tax expenditures related to consumption taxes**

In accordance with its mandate, the committee systematically analyzed the tax expenditures related to consumption taxes. Volume 2 of this report presents details of the analysis conducted and the outcomes.

The revisions that the committee is proposing represent reductions of **$201 million** in tax expenditures.

The revisions would broaden the tax base of consumption taxes.

Revisions of tax expenditures related to consumption taxes

The tax expenditures whose abolition the committee recommends

- Refund in respect of automatic door openers for use by persons with a disability
- The exemption accorded to the Société Saint-Jean-Baptiste de Montréal
- A reduction in the rate of the specific tax applicable to beer sold by microbreweries and the tax on alcoholic beverages sold by small-scale producers
- Zero-rating of children's diapers and breast-feeding items
- Zero-rating of books[1]
- Tax refund granted to the purchasers of new homes
- Tax refund granted to lessors of new residential apartment buildings

The tax expenditures whose modification the committee recommends

- The tax refund granted to charitable organizations and certain non-profit organizations[1]
- The tax refund granted to schools, colleges and universities[1]
- The tax refund granted to hospitals[1]
- The tax refund granted to the municipalities[1]
- A reduction in the rate of the aviation fuel tax

[1] The amounts generated would be reallocated.

Broader recourse to user fees

The significant reduction in personal income tax would also be funded by means of broader reliance on user fees.

The committee has concentrated its analysis on two specific user fees, i.e. reduced-contribution childcare expenses and Hydro-Québec's electricity rates.

- Concerning reduced-contribution childcare services, the committee recommends fiscalization of the rates that protects low- or middle-income families while generating additional revenues in relation to the reform announced by the government.
- As for Hydro-Québec, the committee recommends an increase in the price of heritage pool electricity and a new tax on overconsumption of electricity in the household sector.

Such recourse would generate **$806 million**:

- **$101 million** in additional savings through the fiscalization of reduced-contribution childcare rates;
- an increase in the price of heritage pool electricity and a new tax on the overconsumption of electricity in the household sector, thereby generating **$705 million**.
    - $623 million from the increase in the cost of heritage pool electricity;
    - $82 million from the levying of a tax on the most energy-intensive consumers.

Support measures for the most disadvantaged

The committee believes that it is essential to protect the most disadvantaged from the impact of broader recourse to consumption taxes and user fees.

Recommendation 16

The committee recommends that **$310 million** be earmarked to enhance the solidarity tax credit in order to protect the most disadvantaged against the deterioration of their financial situation that may stem from the new mix of taxes and the proposed tax increases.

This amount is added to the other measures that the committee is proposing that benefit the most disadvantaged, including:

- the increase in the basic personal amount;
- the reduction of the tax rates;
- the enhancement of the work premium that the committee is, moreover, recommending.

The enhancement of the solidarity tax credit

The committee is proposing that the $310 million be allocated to the enhancement of the solidarity tax credit in order to offset broader recourse to consumption taxes and user fees.

The recommendation is one of the proposals that the committee has formulated to ensure the equitable redistribution of collective wealth and adequate support for the most disadvantaged.[25]

An increase in the basic personal amount

In addition to the enhancement of the solidarity tax credit, the increase in the basic personal amount that the committee is proposing would raise the work income threshold exempted from taxation to $18 000.

The amount is considerably higher than the current basic personal amount that avoids taxation up to a threshold of $14 281. The proposed increase would avoid taxing taxpayers on the income necessary to cover what are deemed to be essential needs.

The reduction of the tax rates

The reduction in the rates of the first tax brackets in the tax rate schedule that the committee is proposing will benefit low-income taxpayers and all taxpayers.

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[25] See page 208.

The introduction of the proposed reform: corporate tax

The committee's proposed tax reform would lead to several major modifications to corporate tax.

Again with a view to fostering economic growth and a higher standard of living, the committee is proposing measures that would reduce corporate tax by **$1.6 billion**.

- The committee recommends a reduction of nearly **$0.7 billion** in corporate tax to be applied uniformly to all corporations through a significant reduction in the tax rate.
- A "growth premium" would be implemented for SMEs at a cost of nearly **$0.5 billion**.
- SMEs would benefit from a reduction in the payroll tax of more than **$0.4 billion**.

The corporate tax cut would be funded by means of:

- a revision of tax expenditures from which businesses benefit, which would generate **$1.1 billion** in net savings;
- a revision of the current corporate taxation mix through broader reliance on user fees, which would generate **$0.5 billion**.

All told, the foregoing modifications to corporate tax would have a zero cost for taxpayers. The overall tax burden of corporations would neither increase nor decrease.

TABLE 5

Changes to the mix of taxation methods of corporations – Summary
(millions of dollars)

	Cost for the government
Reduction in corporate tax	**1 575**
– Reduction of the general tax rate	675
– New growth premium for SMEs	470
– Reduction in the payroll tax for SMEs	430
Revision of tax expenditures from which businesses benefit	**(1 075)**
– Enhancement of tax expenditures pertaining to the cultural sector	5
– Elimination of the current small business deduction	(550)
– Elimination for large businesses of the full refundability of tax credits	(325)
– Revision of other tax expenditures	(205)
Broader recourse to user fees (electricity)	**(500)**
TOTAL	**0**

■ A significant reduction in the corporate income tax rate: a uniform rate of 10%

Recommendation 17

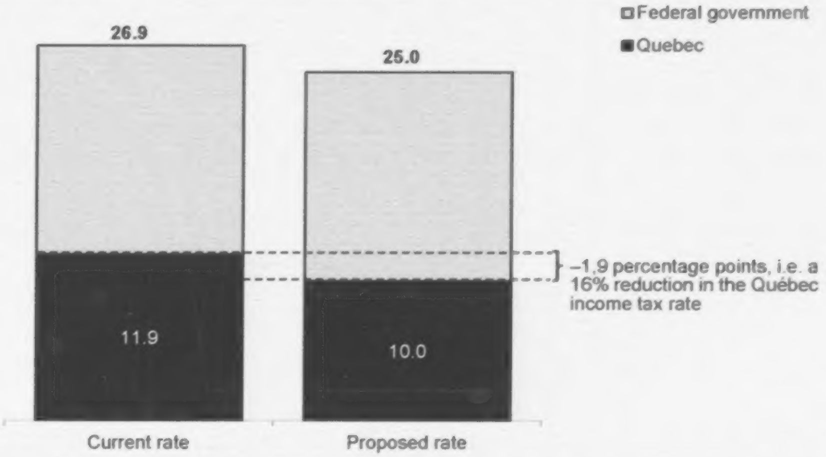
The committee recommends reducing from 11.9% to 10% the corporate income tax rate.

The reduction of nearly 2 percentage points in the tax rate corresponds to a reduction of nearly 16% in the tax rate. The tax rate combined with the federal rate would, accordingly, stand at 25%.

The tax reduction would represent a **$675-million** gain for corporations.

CHART 3

Corporate income tax rates
(percentage rate)



The reduced tax rate would improve Québec's tax competitiveness and foster economic growth. It would enhance the profitability of investments, thereby enabling businesses to invest more extensively in their growth. It would attract foreign firms to Québec.

The reduction in the general tax rate would enable Québec businesses to benefit from Canada's lowest general income-tax rate, equivalent to that in Alberta.

- **Arguments presented by certain economists**

In a study carried out at the committee's request, Jean-François Wen, Bev Dahlby and Ergete Ferede suggest that a reduction in the corporate tax rate and the elimination or reduction of the investment tax credit would enhance economic efficiency and long-term growth in Québec.[26]

In a previous study, Bev Dahlby and Ergete Ferede estimated that a one-percentage-point reduction in the provincial corporate tax rate would engender a 0.1- to 0.2-percentage-point increase in the provincial annual economic growth rate, which is considerable in the context of average annual real GDP growth on the order of 1.5%.[27]

Another study by Bev Dahlby concluded that the Canadian provinces would experience higher economic growth rates were corporate income tax to be reduced for a higher sales tax or higher personal income tax. This conclusion assumes that the new tax mix would have zero cost, i.e. it would not affect tax revenues.[28]

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[26] In the study, the authors do not produce estimates of the impacts on Québec's economic growth. Their conclusions stem from their estimates of the marginal cost of the public funds associated with various taxes. See Jean-François Wen, Bev Dahlby and Ergete Ferede, *Les implications des distorsions fiscales sur la réforme fiscale au Québec*, November 24, 2014, in Volume 5 of this report.

[27] Bev Dahlby and Ergete Ferede, "The Effects of Tax Rate Changes on Tax Bases and the Marginal Cost of Public Funds for Provincial Governments" in *International Tax and Public Finance*, Vol. 19, December 2012, pages 844-883.

[28] Bev Dahlby, "Reforming the Tax Mix in Canada" in *SPP Research Papers*, Vol. 5, No. 14, The School of Public Policy, University of Calgary, April 2012.

A “growth premium” for SMEs

The committee recommends the introduction of a “growth premium” for SMEs to replace the existing small business deduction.

Such a premium would cost the government **$470 million**.

The new “growth premium” would replace the existing small business deduction, which defines a reduced income-tax rate for SMEs, at a cost of $550 million. The new premium would cost $80 million less than the existing small business deduction.

- **Criticism of the existing small business deduction**

The existing small business deduction arouses widespread criticism.

The main reason mentioned to justify a reduced rate for SMEs is that the smallest enterprises find it harder than large companies to finance their operations or projects. According to research by the OECD, the studies conducted do not confirm the effectiveness of a reduced rate.[29]

The same study notes that specific treatment for SMEs appear to represent “a serious distortion, which dissuades businesses from achieving an optimum size to realize economies of scale.” [OUR TRANSLATION] Accordingly, a tax system that is advantageous for small enterprises may adversely affect their growth.

Other data presented in the same study show that “a corporate tax reduction for large businesses would have a much more beneficial impact on growth than for small enterprises, partly because the latters’ profitability is too limited to be appreciably affected by corporate tax.” [OUR TRANSLATION]

The same reasoning appears to apply to manufacturing SMEs, which benefit in Québec from an additional enhancement of the small business deduction.

- **Recognition of the Canadian context**

However, in the Canadian context the committee notes that Québec SMEs are competing with SMEs from the rest of Canada, where specific, advantageous tax treatment more often than not exists.

For this reason, the committee recommends the maintenance of specific treatment for SMEs in the form of a “growth premium.”

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[29] “Tax reform for efficiency and fairness” in *OECD Economic Surveys : Canada 2008*, June 2008, pages 83-84.

Recommendation 18

The committee recommends the introduction of a "growth premium" for SMEs, which would replace the current small business deduction.

The premium would take the form of a tax credit or a deduction for private companies that reduces from 10% to 4% the tax rate on corporate income on the taxable income bracket between $100 000 and $500 000.

The new premium would encourage small enterprises to grow in order to reach levels of income that allow them to benefit from favourable tax treatment.

Eligibility for the new premium would be limited to Canadian-controlled private corporations with paid-up capital of less than $15 million, as is the case for the existing small business deduction.

What is more, access to the rate would be limited to corporations with at least five employees.

The "growth premium" would cost **$470 million**, i.e. $80 million less than the existing small business deduction.

- **Correct an injustice**

Limiting access to the rate to corporations with at least five employees would also partly correct the injustice noted: a significant number of self-employed workers or professionals incorporate in order to take advantage of the tax benefits that accrue when they exercise their activities through a corporation.

Incorporation gives them access to certain tax planning possibilities that allow, in particular, tax deferral, a significant tax benefit. Salaried workers are unable to resort to incorporation that allows for such benefits.

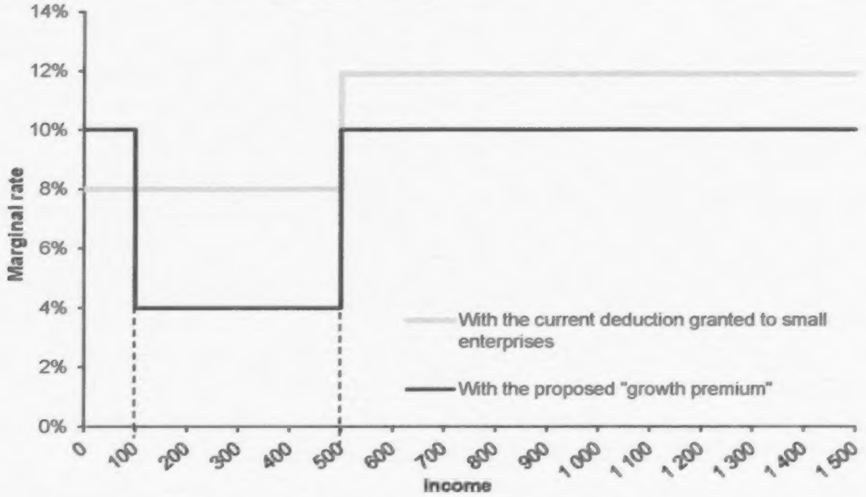
Without this exclusion, the growth premium would engender an additional cost of roughly $125 million.

- **Impact on eligible SMEs in sectors other than the manufacturing sector**

For eligible SMEs in sectors other than the manufacturing sector, the growth premium, combined with the reduction in the income-tax rate from 11.9% to 10% would offer a marginal tax rate below the current rate for all corporations with taxable income exceeding $100 000.

CHART 4

Marginal tax rate on the income of an SME, except in the manufacturing sector – 2015
(percentage rate and income in thousands of dollars)



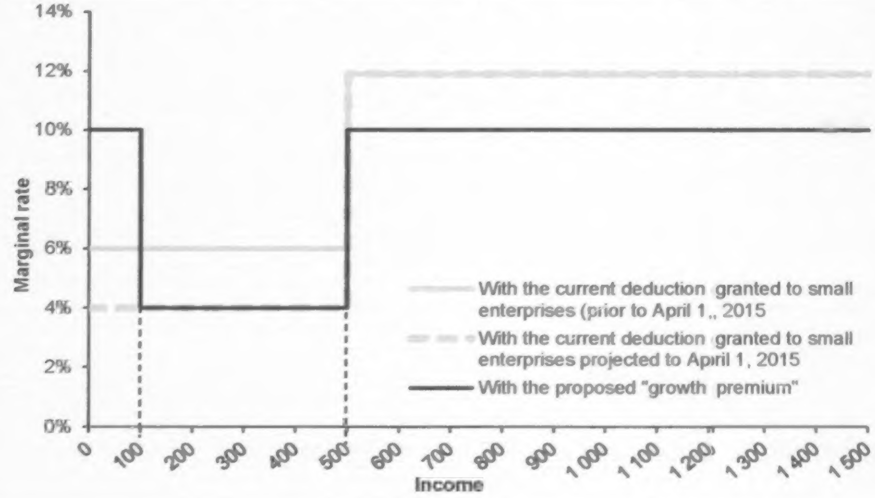
- **Impact on SMEs in the manufacturing sector**

For eligible SMEs in the manufacturing sector, which now benefit from preferential treatment in relation to other sectors, the marginal rate would be lower than or equal to the current rate for all income exceeding $100 000.

Compared with the rate announced for April 1, 2015 applicable to them, the tax rate would be equivalent between $100 000 and $500 000 and lower on income beyond $500 000 as a result of the proposed reduction in the tax rate.

CHART 5

Marginal tax rate on the income of an SME in the manufacturing sector – 2015
(percentage rate and income in thousands of dollars)



- **A genuine growth premium**

The application of the new "growth premium" would significantly reduce the effective tax rate as the company's income increases between $100 000 and $500 000.

The tax rate of small enterprises with less than $100 000 in taxable income would increase in relation to the application of the current deduction.

- The additional tax could not exceed $2 000, except in the manufacturing sector that now benefits from preferential treatment and in respect of which the maximum additional tax would be $4 000 or $6 000 commencing on April 1, 2015, were the government to confirm the additional enhancement announced.
- Small enterprises would, however, have access to the reduced tax rates if they grow.

TABLE 6

Tax payable in the current situation and in the proposed situation, except for the manufacturing sector – 2015
($)

Taxable income	Current situation	The committee's proposal	Tax differential
100 000	8 000	10 000	2 000
250 000	20 000	16 000	−4 000
500 000	40 000	26 000	−14 000
750 000	69 750	51 000	−18 750
1 000 000	99 500	76 000	−23 500
1 250 000	129 250	101 000	−28 250
1 500 000	159 000	126 000	−33 000

TABLE 7

Tax payable in the current situation and in the proposed situation, manufacturing sector – 2015
($)

	Prior to April 1, 2015			Commencing on April 1, 2015		
Taxable income	**Current situation**	**The committee's proposal**	**Tax differential**	**Anticipated situation**	**The committee's proposal**	**Tax differential**
100 000	6 000	10 000	4 000	4 000	10 000	6 000
250 000	15 000	16 000	1 000	10 000	16 000	6 000
500 000	30 000	26 000	−4 000	20 000	26 000	6 000
750 000	59 750	51 000	−8 750	49 750	51 000	1 250
1 000 000	89 500	76 000	−13 500	79 500	76 000	−3 500
1 250 000	119 250	101 000	−18 250	109 250	101 000	−8 250
1 500 000	149 000	126 000	−23 000	139 000	126 000	−13 000

▪ Greater neutrality

The "growth premium" that the committee is proposing would benefit businesses in all areas of activity, without distinction.

In relation to the existing small business deduction that offers preferential treatment to SMEs in the manufacturing sector, the growth premium would be more neutral and more equitable toward businesses in all sectors.

The committee's proposals and respect for the principle of integration

The principle of integration

To ensure the neutrality of the tax regime and avoid double taxation, an integration mechanism between the personal income tax system and the corporate taxation system has been established to make sure that dividend income is taxed at a similar rate to work income.[1]

Respect for the principle, in relation to the committee's proposals

New tax rates, such as those that the committee is proposing, would alter the neutrality of the taxation system for corporations.

To make the taxation system more neutral, the provincial rate of the increase and the dividend tax credit should be adjusted to take into account the new tax rates that the committee is proposing, both as regards the reduction in the general rate and the new growth premium.

[1] For additional information, see Part 6 of Volume 3 of this report.

A reduction in the payroll tax rate for SMEs

Québec collects from businesses a payroll tax called the Health Services Fund contribution.

Recommendation 19

The committee recommends reducing from 2.7% to 1.6% the rate of the payroll tax for SMEs, which would reduce their tax burden by **$430 million**.

A distinction must be made between this tax, which is paid into the Consolidated Revenue Fund, and payroll taxes, which fund certain specific programs from which employees benefit.

The justification for differential treatment for SMEs

The Québec taxation system is noteworthy for its heavy payroll tax in relation to the other three provinces in which such a tax exists.

The payroll tax is a fixed charge that is more of a burden for SMEs than for large businesses. The fixed charge also imposes additional constraints respecting liquid assets for SMEs.[30]

Differential treatment is, therefore, warranted between small and large businesses in this instance.

A reduced rate for all sectors

The rate would apply to businesses in all sectors to avoid favouring a specific sector to the detriment of the others.

SMEs in the primary and manufacturing sectors have benefited from this rate since January 1, 2015. As for the other SMEs now subject to the 2.7% rate, they would enjoy a reduction in the payroll tax of more than 40%.

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[30] For additional information, see Part 6 of Volume 3 of this report.

Social contributions

The burden of social contributions

In addition to the payroll tax, businesses must bear the additional expense of social contributions.

Québec does not stand out in terms of significantly higher social contributions than elsewhere, which is not true of the payroll tax. When exemptions and maximum insurable earnings are excluded, social contributions account for roughly 10.2% of the total payroll in Québec, compared with 10% in Ontario and 9.5% in the Canadian provinces overall.

However, the reduction in the payroll tax should not be perceived as a pretext for increasing the existing social contributions.

The "1% tax"

Corporations are obliged to devote 1% of their total payroll to manpower training and those that fail to do so must pay the equivalent into a manpower training fund that the Commission des partenaires du marché du travail manages.

Although the measure is known as the "1% tax" it is not a fiscal measure. The committee did not, therefore, analyze it.

However, it is an expense on the total payroll that is added to taxes and other social contributions.

Funding the reduction in corporate tax

Recommendation 20

The committee recommends that the reduction in corporate tax be funded by means of:

- a revision of tax expenditures from which businesses benefit, which would generate **$1.1 billion** in net savings:
  - the elimination of the full refundability of tax credits for large businesses, which, in the long run, would generate recurring savings of **$325 million**;
  - the elimination of the existing small business deduction, representing a recurring saving of **$550 million**, for a net saving of $80 million bearing in mind the new "growth premium;"
  - certain enhancements of tax measures concerning the cultural sector, estimated at **$5 million**;
  - the revision of other tax expenditures, which will generate additional savings of **$205 million**;
- broader recourse to user fees, i.e. an increase in the price of heritage pool electricity, which will generate **$500 million**.

A revision of tax expenditures from which businesses benefit

The committee is proposing that the reduction in corporate tax be funded, by and large, through a revision of tax expenditures from which businesses benefit.

With that in mind, the committee recommends that the tax expenditures be tightened, which will generate net annual savings of **$1.1 billion**. The savings include the impact of the elimination of the small business deduction, estimated at **$550 million**.

As it did in the case of personal income tax, the committee conducted a systematic, thorough examination of the tax expenditures from which businesses benefit. Volume 2 of the report indicates the approach that the committee adopted and its conclusions in respect of existing tax expenditures.

More specifically, the committee recommends:

- the elimination of the full refundability of tax credits for large businesses;
- certain enhancements of tax expenditures pertaining to the cultural sector;
- other reductions in existing tax expenditures.

- **The elimination of the full refundability of tax credits for large businesses**

The committee has pinpointed a tightening measure that applies simultaneously to several tax expenditures, i.e. the elimination of the full refundability of tax credits for large businesses.

The refundability of tax credits is a general characteristic that applies to most tax credits granted to corporations.

The refundable nature of such tax credits engenders certain undesirable economic impacts.

— A number of companies benefit repeatedly from the refundability of tax credits although their tax payable year after year is lower than the value of the credits.

— The existence of refundable tax credits does not encourage businesses to generate profits in Québec.

Recommendation 21

From the standpoint of the revision of the tax expenditures from which corporations benefit, the committee recommends that the principle of refundability only be totally or partially maintained for Canadian-controlled private corporations with taxable income below $800 000 and whose worldwide paid-up capital does not exceed $50 million.

Furthermore, the committee recommends that the contributions to the Health Services Fund for all corporations be considered in the determination of the refundable portion of the tax credit, in addition to income tax.

This measure would generate recurring savings of **$325 million**.

It could be introduced gradually, over five years, to enable corporations to adapt to it.

The committee made this recommendation to the government in its interim report to pinpoint immediate tightening measures to allow for the attainment of the objectives of Budget 2014-2015.[31]

The measures were proposed in the specific context of the budgetary targets defined by the government. The committee is maintaining this recommendation but this time pursuant to the proposed reform: the limitation of the refundability of tax credits would fund the reduction in corporate tax.

The measures could be introduced gradually, over five years, to enable corporations to adapt to it.

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[31] Volume 4 of this report presents all of the proposals that the committee submitted.

- **Certain enhancements of tax expenditures pertaining to the cultural sector**

Recommendation 22

Still on the theme of the revision of the tax expenditures from which corporations benefit, the committee has identified certain enhancements to the tax measures pertaining to the cultural sector, estimated at **$5 million**.

The committee also recommends that the possibility be examined of levying a tax on residential Internet services in order to support, in particular, the funding of existing tax measures or new culture-related measures.

The tax assistance pertaining to the cultural sector does not pursue economic goals alone. It also targets cultural objectives, i.e. to offer Quebecers original cultural production, mainly in French, and to broaden the influence of Québec culture abroad.

As is the case in the tax expenditures studied overall, the committee has pinpointed a number of tightening measures in the sector. However, it is proposing enhancements to the tax credit for the production of sound recordings, the tax credit for the production of performances, the tax credit for film dubbing and the tax credit for book publishing.

- **Other reductions in existing tax expenditures**

Generally speaking, the examination of the other tax expenditures from which corporations benefit has led the committee to recommend numerous other possible reductions in existing tax expenditures that will generate additional savings of **$205 million**.

A revision of tax expenditures related to corporate income tax

The tax expenditures whose abolition the committee recommends

- Refundable tax credit for taxi drivers and taxi owners
- Refundable tax credit for technological adaptation services
- Additional deduction of 100% in the calculation of the employer's income (public transportation)
- Refundable tax credit for the operator of an international financial centre (IFC)
- Tax credit relating to resources

The tax expenditures whose modification the committee recommends

- Refundable tax credit for design
- Refundable tax credit for the reporting of tips

The opportunity cost of maintaining a tax expenditure

Any tax measure has a positive impact when no account is taken of the other possible uses to which the amounts invested in it might be put.

Under its zero-cost reform, the committee has decided to favour a corporate income tax cut and a reduction of the payroll tax without favouring one area of activity over another one. It is of the opinion that this will guarantee more robust economic growth and enhanced wealth creation.

However, such a choice accordingly requires a reduction in other targeted tax expenditures that are less beneficial to the economy. Failure to reduce such tax expenditures would concomitantly reduce the leeway available to act in favour of all corporations by means of the streamlining of corporate income tax or the payroll tax.

An example

Accordingly, a genuine opportunity cost arises when we decide to maintain a tax expenditure.

For illustrative purposes, below is an example of the scope of the reduction in corporate income tax or the payroll tax that we would forego were any of the committee's recommendations not implemented.

The elimination of the full refundability of tax credits for large businesses that would generate in the long run $325 million in savings represents:

- 0.90 percentage point on the general corporate income tax rate of 11.9%;
- 0.81 percentage point on the rate of 2.7% of the contributions of SMEs to the Health Services Fund.

- **Broader recourse to user fees**

The corporate tax cut would also be partly funded through broader recourse to user fees, which would generate **$500 million** annually.

With respect to corporations, the committee's recommendation to resort more extensively to user fees concerns Hydro-Québec's electricity rates.

The committee's recommendation concerning the cost of heritage pool electricity formulated earlier would also affect corporations, except for Hydro-Québec's large industrial clients under the L rate.

Possible adjustment of the reform

The reform that the committee is proposing is substantial. Should the government decide to adjust its application, choices would have to be made.

Indeed, were the government to decide not to implement certain restraint measures, not all of the proposed tax cuts could be granted. For example, the government might decide not to fully apply the recommendation concerning the elimination of the full refundability of tax credits for large businesses or to maintain tax measures whose abolition the committee recommends.

Adjust the corporate income tax cut

In such a case, the committee has identified a possible adjustment concerning the application of the reduction to 10% of the corporate income tax rate. If the amounts generated are insufficient to fully implement the recommendation, the financial, oil and mining sectors could be initially excluded from it.

- The exclusion of the financial sector would lower the cost of the reduction in the general tax rate from $675 million to $490 million, a difference of $185 million.
- The exclusion of the oil and mining sectors would reduce the cost of the recommendation by an additional amount of $20 million.

Justifiable exceptions

While the committee is, by and large, recommending the avoidance of differential treatment between economic sectors, such exceptions may be justifiable.

- In the case of the financial sector, it should be noted that starting in 2019, the temporary contribution of financial institutions will be abolished. Accordingly, financial institutions will already benefit from a tax rate reduction. Were the 11.9% income-tax rate to be maintained, their tax burden would remain more or less constant after the elimination of the temporary contribution.
- As for the mining sector, mention should be made of the coming into force in 2014 of a new mining regime to ensure a fair contribution from corporations exploiting Québec's natural resources established, in particular, on the basis of an 11.9% tax rate for large corporations. Maintaining the 11.9% tax rate in respect of such corporations would maintain the contribution thus established in respect of their natural resource exploitation.

1.2 A medium-term perspective: a review of the taxation of capital gains

The revision of the method of taxation of capital gains would follow the same logic as the implementation of a dual income tax system by eliminating the favourable tax treatment of this type of gain.

☐ Modify the existing regime

Under the existing regime, the treatment of capital gains is an integral part of personal income tax, as is the case for corporate income tax.

In Québec as in Canada as a whole, such treatment is subject to specific rules more favourable than the general regime, which means that they are deemed to be tax expenditures.[32]

Four tax expenditures thus concern the taxation of capital gains or are linked to them:

— the partial inclusion of capital gains, which defines the specific tax treatment from which income of this nature benefits both for individuals and for corporations;

— the non-taxation of the capital gain on principal residences;

— the lifetime capital gains exemption;

— the preferential treatment accorded stock options granted to employees.

The changes that the committee is proposing cover the four components.

Recommendation 23

The committee recommends a comprehensive revision of the taxation of capital gains.

The revision would seek to treat more fairly capital gains compared with other sources of income.

— It would cover the medium term and require Canada-wide coordination to avoid capital gains realization simply shifting outside Québec were Québec to act alone.

— The revision would not be applied retroactively, i.e. it would not apply to capital gains prior to the implementation of the recommended reform.

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[32] For additional information, see Part 5 of Volume 3 of this report.

☐ The partial inclusion of capital gains

Recommendation 24

The committee recommends the elimination of the partial inclusion of capital gains and its replacement by the recognition of the real capital gain, i.e. the capital gain that takes into account inflation. The capital gain would thus be taxed normally, like any other income.

— In the case of capital gains realized at the time of disposition of property owned for less than one year, the capital gain would be taxed like any other income.

— Beyond the one-year time limit, the capital gain realized would be adjusted to take into account inflation.

Such a medium-term change would require coordination between the other provinces and the federal government.

The committee's proposal concerning the taxation of capital gains realized at the time of disposition of property owned for less than one year is the rule in the United States.

At present, capital gains are partly taxed. Only half of the capital gain is considered in the determination of taxable income. This partial inclusion "seeks to recognize that the appreciation in the value of a property does not necessarily correspond to enrichment for the taxpayer, bearing in mind inflation."[33]

The inclusion rate has often varied over time and is not linked to inflation. To a large extent, the rate seems arbitrary. It is especially hard to justify such a rate to offset inflation for property owned over a short period.

The revision that the committee recommends is substantial. It would more fairly treat capital gains in relation to other sources of income.

— For a period of ownership of less than one year, the capital gain would be taxed like any other income.

— For a period of possession exceeding one year, the taxation would decrease according to the number of years of ownership of the property before its sale and the inflation rate applicable during that time.

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[33] Ministère des Finances du Québec, *Dépenses fiscales – Édition 2013*, March 2014, page B.117.

The treatment of the capital gain in other jurisdictions

In 2013, the OECD produced a study that clearly describes the treatment of the capital gain in numerous jurisdictions,[1] which, the study reveals, take into account the holding period of property to determine the inclusion rate of the capital gain. The holding period varies considerably from one country to the next.

Without listing all of the countries, Germany, Australia, Belgium, the United States and Finland apply specific treatment depending on the holding period.

The study also reveals that certain jurisdictions such as Chile, Spain, Portugal and Mexico take into account inflation in order to determine the taxable portion of the capital gain.

[1] Michelle Harding, "Taxation of Dividend, Interest and Capital Gain Income" in *OECD Taxation Working Papers*, No. 19, 2013.

❑ The non-taxation of the capital gain on principal residences

Recommendation 25

The committee recommends that specific treatment of the capital gain on principal residences be maintained.

However, the measure should be tightened in order to:

- exclude gains stemming from speculation;
- tax a portion of the gains stemming from stellar returns by limiting the exemption to an indexed lifetime amount of $1 million.

This is a medium-term change that would require coordination between the other provinces and the federal government.

To this end, the committee is proposing to:

- tighten the rules in order to detect cases of speculation, in particular through an explicit definition of the very concept of speculation;
- limit the non-taxation of a $1-million indexed lifetime capital gain.

The rules would only apply to capital gains actually realized, i.e. on the capital gains obtained at the time of sale of the principal residence.

Since the principle of the non-taxation of the capital gain on principal residences would remain, there is no reason to make mortgage interest deductible.

This change would not be retroactive, in the same way as the revision of the partial inclusion.

❑ The lifetime capital gains exemption

Recommendation 26

The committee recommends that the existing lifetime capital gains exemption be replaced by an additional contribution to the registered retirement savings plan (RRSP) in order to directly foster saving for retirement.

This is a medium-term change that would require coordination between the other provinces and the federal government.

This recommendation is one of the proposals that the committee is putting forward to encourage personal savings. The committee returns to the matter in greater detail by broaching this objective.[34]

In the short term, the committee has pinpointed several solutions to facilitate the transfer of businesses between persons dealing on a non-arm's length basis by proposing the amendment of the existing rules governing the non-eligibility for exemption of capital gains, one of the initiatives proposed to foster business investment. This recommendation is presented in detail with this objective.[35]

❑ The preferential treatment accorded stock options granted to employees

The reduction of the taxable benefit related to the acquisition of stock options is more or less modeled on the taxation of capital gains. Since it has been proposed in the medium term to abolish the partial inclusion of the capital gain, it would be logical to also abolish the preferential treatment accorded stock options.

Recommendation 27

The committee recommends the abolition of the preferential treatment accorded stock options granted to employees.

This is a medium-term change that would require coordination between the other provinces and the federal government. In the short term, the committee is formulating other recommendations (Recommendation 41).

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[34] See page 150.

[35] See page 117.

1.3 Long-term reflection: the examination of a dual income tax system

Even if the tax mix is modified, income tax will continue to predominate under our tax system.

Recommendation 28

To make income tax more favourable to economic growth and a higher standard of living, the committee recommends that Québec examine the implementation of a dual income tax system, following the example of the Scandinavian countries.

The committee wishes to emphasize that more detailed analyses should be conducted to determine whether this avenue is the one that should indeed be emphasized in the long term.

The collaboration of the other Canadian jurisdictions would, moreover, be essential.

☐ The characteristics of a dual income tax system

As its name indicates, a dual income tax system comprises two forms of taxation. The system's originality lies in the differential treatment accorded work income and capital income.

A dual income tax system is characterized by:

— a progressive tax rate schedule that is fairly high on work income;

— a single, low rate for capital income and corporate income.

Under the dual income tax system, the tax on capital income applies to the broadest possible tax base.

❑ The interest aroused by the dual income tax system

Starting in the 1990s, the Scandinavian countries gradually adopted variants of the dual income tax system. Other European countries such as the Netherlands adopt some but not all facets of it.

Work income is thus taxed at much higher rates than capital income. On the other hand, the tax on capital income applies to the broadest possible tax base: there are no provisions such as the partial inclusion or exemption of capital gains for income tax purposes.

Several experts have proposed adopting a dual income tax system in Canada.

■ Arguments presented by certain economists

Kevin Milligan, a Canadian economist, very recently presented convincing arguments in favour of the implementation of such a system.[36]

— A dual income tax system would bolster the progressivity of tax and thereby tackle the problem of growing income inequality. Over the past 30 years, the concentration of income in the highest income brackets apparently stems primarily from the unprecedented growth in employment income. The broader taxation of employment income compared with capital income means, in a manner of speaking, more broadly taxing the income of the wealthiest taxpayers when they earn such income, instead of subsequently when capital income is produced.

— A single, lower rate on capital income would be better adapted to the current context of greater capital mobility and the attendant erosion of the tax base.

— Kevin Milligan believes that the implementation of a dual income tax system must first hinge on a broadening of the tax base.

Jack Mintz, another Canadian economist, also proposed before him such a system.[37]

Peter Birch Sørensen, a Danish economist, also proposed the perspective of a dual income tax system adapted to the Canadian situation.[38]

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[36] Kevin Milligan, *Tax Policy for a New Era: Promoting Economic Growth and Fairness*, 2014 C.D. Howe Institute Benefactors Speech, November 2014.

[37] Jack M. Mintz, *The 2006 Tax Competitiveness Report: Proposals for Pro-Growth Tax Reform*, Commentary 239, C.D. Howe Institute, September 2006.

[38] Peter Birch Sørensen, "The Nordic Dual Income Tax: Principles, Practices, and Relevance for Canada" in *Canadian Tax Journal*, Vol. 55, No. 3, 2007, pages 557–602.

Potential advantages

More generally speaking, we note that a dual income tax system simplifies the application of the tax regime. It is more neutral in the treatment of income and the realization of capital income over time. It takes into account capital mobility and avoids the erosion of the tax base.

The dual income tax system encourages savings since the return on savings is taxed at a lower rate.

Under a dual income tax system, lower taxation of capital income reduces the incentive for capital flight.

Québec's adoption of a dual income tax system might, therefore, offer numerous advantages. In particular, the introduction of such a system would:

— enhance the Québec economy's competitiveness; and

— thereby foster the investment essential for growth in productivity.

Challenges that require significant reflection

However, challenges may arise and thorough reflection is essential in this respect.

— It would be necessary to apply strict rules to avoid having taxpayers shift work income to capital income.

— The reduction of tax on capital income may be poorly perceived if there is no guarantee that the redistribution of wealth can be maintained.

Such a reform would demand extensive preparation.

The dual income tax system: the potential shift of work income to capital income

The introduction of a dual income tax system poses certain challenges, in particular as regards the equitable treatment of wage earners and self-employed workers.

A potential problem

Given the striking difference between the maximum marginal tax rates on work income and capital income, certain taxpayers might be encouraged to describe their income as capital income instead of work income.

The Norwegian solution

Norway has adopted the solution of dividing the income of self-employed workers into a work income component that remunerates occupational activities and a capital income component made up of the return on savings invested in the enterprise.

The portion deemed to be work income is taxed under a progressive tax rate schedule and the portion deemed to be capital income is taxed at a single rate.

The Icelandic solution

Iceland decided instead to charge the minimum wage as the salary of self-employed workers and to allocate the remaining income to capital income.

2. ENCOURAGE BUSINESS INVESTMENT

The second objective, **to encourage business investment**, logically stems from the first objective and acts upon one of the sections of the committee's mandate.

Businesses contribute to creating wealth and growth through their investments. Taxation is the ideal tool to promote private investments.

The taxation system's competitiveness reflects this reality: the Québec taxation system must compare favourably with the tax regimes of its economic partners in order to create conditions conducive to business investment.

❑ Rely as a matter of priority on measures of general scope

The committee is convinced that corporate income tax cuts and reductions in the payroll tax rates recommended earlier will, first and foremost, spur business investment.

To induce businesses to invest more, the committee is thus focusing mainly on the reduction to 10% of the general corporate tax rate, the establishment of a growth premium for SMEs, and a payroll tax reduction for SMEs.

The reduction in the general tax rate would enable Québec businesses to benefit from Canada's lowest general income-tax rate, which should directly affect investment.

The committee thus concurs with one of the key recommendation of the Task Force on Business Investment, whose deliberations led to the report submitted to the government in March 2008. The task force then recommended to the government that it lower the general corporate income tax rate to 10% instead of introducing a general investment credit.[39]

The committee is thus relying above all on measures of general scope to stimulate business investment.

❑ Four additional recommendations

The committee is proposing four additional recommendations:

— the revision of certain tax measures;

— more effective recourse to tax-advantaged funds;

— business transfers between persons dealing on a non-arm's length basis;

— a harmonized system for stock options awarded to employees for large businesses.

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[39] *Québec Welcomes Investment – Report of the Task Force on Business Investment,* Québec, March 2008, page 167.

Distortions stemming from selective tax relief

According to the OECD, the contribution that tax cuts make to productivity and growth depend not only on the capacity to stimulate investments but also on the effective distribution of such investments.

Given that tax cuts can target certain sectors or types of enterprises, they risk being wasted on relatively less efficient investments.

Preferential tax systems, such as reduced rates or deductions, further complicate the tax legislation, increase costs and create the possibility of rent-seeking and tax evasion.

As a general rule, the distortions induced by the pursuit of irrelevant objectives—set, for the most part, under the influence of pressure groups or political parties—erode the tax base and impair the quality of investment.

They are often counterproductive, very costly and opaque.

Source: OECD, *Tax Reform for Efficiency and Fairness*, OECD Economic Surveys, Canada, 2008.

2.1 The revision of certain tax measures

The tax assistance that Québec offers businesses hinges mainly on six measures:[40]

- the tax credit for the production of multimedia titles;
- the scientific research and experimental development tax credit;
- the tax credit for the development of e-business;
- the tax credit for the integration of IT in manufacturing SMEs;
- the C2i tax holiday for major investment projects;
- the investment tax credit.

The six measures comprise tax expenditures totaling more than $1.0 billion.

The committee has evaluated the tax measures in light of:

- their profitability, i.e. the difference between the cost for public finances and the benefits obtained;
- their importance in ensuring the competitiveness of the sector and Québec's attractiveness in relation to the investments concerned;
- the attainment of certain specific desired outcomes when the measure is implemented.

Based on the information available and the analyses at its disposal, the committee is proposing:

- the enhancement of the tax credit for the production of multimedia titles;
- the maintenance of:
  - the scientific research and experimental development tax credit;
  - the tax credit for the development of e-business;
  - the tax credit for the integration of IT in manufacturing SMEs;
  - the C2i tax holiday for major investment projects; and
  - the non-renewal of the investment tax credit.

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[40] Part 6 of Volume 3 of this report describes the six measures in greater detail.

Difficulties surrounding profitability and the calculation of tax spinoff[1]

A connection can be made between the calculation of tax spinoff from an activity and the tax credit that supports the activity in order to produce a fiscal profitability ratio. The ratio is one factor that public decision-makers take into account when they select activities to support and the level of support to be granted.

The need for a rigorous methodology

The evaluation of tax spinoff must hinge on a rigorous methodology.

The intersectoral model of the Institut de la statistique du Québec is a recognized tool to evaluate the economic and tax spinoff from an activity in Québec. However, the quality of the studies that it uses centres largely on the quality of the data integrated into the model.

The evaluation of an activity must reveal the direct and indirect tax spinoff.

Exclude induced impacts and incidental taxation

Induced tax spinoff, stemming from expenditures made by using wages paid, eludes the intersectoral model and its evaluation demands that we advance several hypotheses concerning the behaviour of wage earners. This task requires a thorough understanding of Québec's economy and its regions. For these reasons, account should not be taken of induced impacts in the analyses of tax spinoff.

The committee believes that incidental taxation should not be considered either in the calculation of spinoff since the amounts are usually used to offer benefits or indemnities and do not generate net income for the government.

Lastly, to refine the evaluation of tax spinoff, the committee is of the opinion that certain basic hypotheses concerning the opportunity cost for workers and the government should be clarified.

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[1] For additional information, see Part 4 of Volume 3 of this report.

❑ The enhancement of the tax credit for the production of multimedia titles

The tax credit has had a direct impact on the establishment and growth in Québec of a rapidly growing sector the world over. Between 2012 and 2016, the global video game market is expected to grow by 7.2% annually, to $83.0 billion in 2016.[41]

Other jurisdictions exercise very stiff tax competition on Québec and engage in genuine tax competition in the sector. While the jurisdictions in question, including Québec, are on the whole losers because of such competition, it is impossible to unilaterally end it. The companies concerned are extremely mobile. The vast majority of large firms in the video game sector in Québec are foreign corporations that can easily delocalize.

The committee notes that the tightening measures adopted in June 2014 within the framework of a parametric cut in all business tax credits might compromise the sector's development in Québec.

However, Montréal benefits from other advantages that must be recognized, in particular a well-developed sector that has achieved a sound level of productivity, and creative, quality manpower.

Recommendation 29

The committee recommends that the tax credit for the production of multimedia titles be enhanced to partly reverse the tightening measure adopted in June 2014. The Category 1 rate would increase from 24% to 28% and the Category 2 rate would rise from 21% to 25%. The rate of the French production premium eligible for Category 1 would be increased from 6% to 7%.

However, the committee recommends that the enhancement of the tax credit rate be accompanied by a ceiling on the tax credit equivalent to $25 000 per year per eligible job.

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[41] PwC, *Global Entertainment and Media Outlook: 2012-2016*, June 2012.

❑ The maintenance of the scientific research and experimental development tax credit

Investments in research and development are essential to ensure the presence in Québec of efficient businesses that offer products adapted to changing worldwide demand.

Tax measures directly affect the competitiveness of businesses that invest in research and development. The committee recognizes that investments in research and development encompass positive externalities, i.e. advantages that affect society as a whole. In the absence of government support, some of the investments would be threatened.

For all of these reasons, tax assistance for research and development must be maintained.

Other observations

Furthermore, the committee has observed that:

— Québec firms experience considerable difficulty in marketing the outcomes of research and development;

— research and development efforts do not translate into intellectual property;

— the government's tightening measure in respect of this tax credit in the December 2014 *Update on Québec's Economic and Financial Situation*—the establishment of a minimum expenditure threshold of $50 000 for corporations with assets equivalent to or less than $50 million—significantly reduced the advantage accorded SMEs in relation to large businesses.

Recommendation 30

The committee recommends the maintenance as is of the existing tax credit for scientific research and experimental development and, more specifically:

— the maintenance at 14% of the rate of the scientific research and experimental development tax credit for large businesses;

— the maintenance at 30% of the rate of the scientific research and experimental development tax credit for SMEs;

— the introduction of budget measures to support the marketing by SMEs of the outcomes of research and development.[42]

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[42] For additional information, see Volume 3 of this report.

❑ The maintenance until its scheduled expiry of the tax credit for the development of e-business

The sector that this tax credit targets is not subject to competition as keen as in other sectors. While information technologies service firms are partly mobile, a fraction of their operations with high added value cannot be delocalized without high risk of adversely affecting service quality.

What is more, the sector has attained maturity and significant tax assistance for it does not seem warranted.

However, the government has already announced that the tax credit would be in force until December 31, 2025.

Recommendation 31

The committee recommends that the tax credit for the development of e-business be maintained until its scheduled expiry date on December 31, 2025 but that it not be renewed thereafter.

❑ The maintenance of the tax credit for the integration of IT in Québec manufacturing SMEs and the lifting of the moratorium

One objective of the tax credit for the development of e-business was to foster the introduction of the information and communications technologies in Québec manufacturing enterprises.

To this end, the government should not target the supply of technologies but demand by intervening directly among Québec manufacturing enterprises.

A tax credit already exists in this respect but it is subject to a moratorium.[43]

Recommendation 32

The committee recommends that that moratorium on the tax credit for the integration of IT in manufacturing SMEs be lifted.

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[43] For additional information on the moratorium, See Ministère des Finances du Québec, Budget 2014-2015 – Budget Plan, June 2014, page A.87.

❑ The maintenance of the C2i tax holiday for major investment projects

The tax holiday attracts direct foreign investments but also encourages businesses established in Québec to undertake major expansion projects.

In all likelihood, the projects would not be carried out in Québec without such assistance. The investments can, potentially, be carried out in all regions of Québec.

By targeting projects with significant spinoff, the tax holiday is a worthwhile strategic tool.

Recommendation 33

The committee recommends the maintenance of the C2i tax holiday for major investment projects.

However, upon its scheduled expiry in 2015, the outcomes obtained should be examined to ascertain its genuine impact and use before it is extended.

☐ The non-renewal of the investment tax credit

This tax credit replaces the former tax credit on wages for the regions. Although it is preferable to the former tax credit on wages, the committee does not believe that it effectively fosters investment.

In 2008, the Task Force on Business Investment noted that a reduction to 10% of the general tax rate was preferable to a general investment tax credit.[44]

Recommendation 34

The committee recommends the immediate abolition of the basic investment tax credit applicable to the central regions.

For the regions eligible for the enhanced rate—remote and intermediate regions—the committee recommends the complete abolition in 2018. Until the tax credit's abolition, the rate applicable in these regions would be adjusted according to the immediate abolition of the tax credit for central regions.

At present, the rate in the central regions is 8% for SMEs and 4% for corporations with paid-up capital equivalent to or greater than $500 million. Since it would be abolished, the rate applicable in remote and intermediate regions would be reduced by 8 percentage points for SMEs and by four percentage points for large businesses, until the complete abolition of the tax credit.

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[44] *Québec Welcomes Investment – Report of the Task Force on Business Investment*, Québec, March 2008, page 167.

The report of the Task Force on Business Investment

The Task Force on Business Investment was established in 2007 to "help the government identify ways to increase investment to sustain economic growth."[1] Chaired by Pierre Fortin, the task force comprised Andrée Corriveau and Jean Boivin.

At the conclusion of its deliberations, in March 2008, it submitted to the government a report containing 21 recommendations.

Recommendation 2 reads as follows:

> The Task Force recommends that the government reduce the general corporate tax rate to 10% by 2012, rather than introduce a generalized tax credit on investment.[2]

The task force justifies this recommendation by emphasizing that numerous analyses confirm that corporate income tax has a significantly negative impact on investment.

A generalized investment tax credit has several drawbacks, including its adoption by the suppliers of capital goods and the exclusivity of the advantage accorded tangible capital.

However, a targeted tax credit for a major economic or social purpose is a major intervention tool that allows for flexibility. The government should not abandon this type of tax credit.[3]

(1) *Québec Welcomes Investment – Report of the Task Force on Business Investment*, Québec, March 2008, page XXIII.
(2) *Ibid.*, page 167.
(3) *Ibid.*, page 168.

2.2 More effective recourse to tax-advantaged funds

The committee's second series of recommendations aimed at promoting investment focuses on tax-advantaged funds, whose efficiency the committee hopes to enhance.

❑ A major tax measure

In the same way as the four tax credits analyzed earlier, tax-advantaged funds are a key tax measure that the government implemented to support investment.

The funds were created to support Québec SMEs by means of non-guaranteed venture capital. They also seek to create or maintain jobs, promote economic growth and enhance productivity and innovation.

Tax-advantaged funds are also intended to promote saving for retirement and to disseminate job economic training. This section of their mission will be broached with the objective of encouraging personal savings.

■ The three tax-advantaged funds

There are three tax-advantaged funds in Québec.

— The first and largest fund is the Fonds de solidarité des travailleurs du Québec (FTQ), established in 1983. As at May 31, 2014, its net assets stood at $10.1 billion.

— Fondaction, the Fonds de développement et de la Confédération des syndicats nationaux pour la coopération et l'emploi, was established in 1995. As at May 31, 2014, its net assets stood at $1.2 billion.

— The Fonds Capital régional et coopératif Desjardins was established in 2001 within the framework of the economic development strategy for Québec's resource regions. As at December 31, 2013, the fund held net assets of $1.5 billion.

Together, the net assets of the two labour-sponsored funds and the Fonds Capital régional et coopératif Desjardins reach nearly $13 billion. The three funds invest more than $800 million annually in Québec firms.

■ Existing measures

The funds benefit from significant tax measures to support subscription of their capital. The Québec government offers a non-refundable tax credit applicable to the acquisition cost of the funds' shares. The acquisition cost is eligible for the deduction for an RRSP contribution in the case of the two labour-sponsored funds but ineligible as regards the Fonds Capital régional et coopératif Desjardins.

The rates of the tax credits are:

- 15% for the Fonds de solidarité FTQ;
- 25% for Fondaction until May 31, 2015, then 15% thereafter;
- 45% for the Fonds Capital régional et coopératif Desjardins.

The subscription limit is $5 000 per shareholder. The two labour-sponsored funds also benefit from a federal tax credit set at 15% in 2014. The rate will fall to 10% in 2015, 5% in 2016 and be eliminated in 2017.

■ An essential role to finance the investments of SMEs

The three funds must comply with investment standards and the rules governing the businesses that may benefit from their support.

The funds play a pivotal role in financing the investments of SMEs. In June 2014, the funds had 840 000 shareholders and were partners with nearly 3 000 businesses.

The committee has noted the strategic role that the tax-advantaged funds play in supporting the investments of SMEs.

It therefore recommends the maintenance of tax support for the three funds, although by proposing several modifications to strengthen the funds' efficiency in supporting investments, without increasing the anticipated cost of the tax measures.

The committee is formulating two series of recommendations:

- the redefinition of the tax credit rates to ensure equivalent profitability of the tax assistance among the three funds;
- several measures to broaden the funds' contribution to Québec's economic development.

Ensure equivalent profitability of the tax assistance among the tax-advantaged funds

Labour-sponsored funds

Recommendation 35

The committee recommends that, as planned, the rate of the tax credit applicable to purchases of shares in the Fonds de solidarité FTQ and Fondaction be standardized at 15%.

For Fondaction, it was announced in 2012-2013 that following a temporary enhancement of the rate in order to offset higher management fees as a proportion of assets, the rate would be harmonized with that of the Fonds de solidarité FTQ. It is not desirable to extend the differential rate beyond the anticipated deadline of May 31, 2015.

Should the government wish to offset for another year or two the higher management fees, it should do so by means of a budget measure.

Fonds Capital régional et coopératif Desjardins

Recommendation 36

The committee recommends that the rate of the tax credit applicable to purchases of shares in the Fonds Capital régional et coopératif Desjardins be reduced from 45% to 25%.

The reduction would enable shareholders of the Fonds Capital régional et coopératif Desjardins to obtain a tax yield comparable to that obtained by the shareholders of the two labour-sponsored funds when account is taken of the eligibility for an RRSP of labour-sponsored fund shares.

The taxation would thus be neutral among the three funds. The decision to purchase a share in a fund would hinge solely on the fund's performance and its characteristics, in particular the sector of intervention, eligibility for the RRSP, and the holding period.

In the case of the Fonds Capital régional et coopératif Desjardins, the committee believes that because of its visibility and improvements in its returns, the fund should also be able to pursue its growth and fulfil its mission.

A comparable yield regardless of the fund

According to the proposed modifications, the return on the tax benefits of the purchase of shares in tax-advantaged funds would be comparable, regardless of the fund.

TABLE 8

Comparison of the yield from tax benefits stemming from the purchase of shares in tax-advantaged funds
(as a percentage)

	Labour-sponsored funds	Fonds Capital régional et coopératif Desjardins
Rate of the tax credit	**15%**	**25%**
Yield		
Over 7 years	4.4	4.1
Over 10 years	3.1	2.9
Over 14 years	2.3	2.0

Note: Hypotheses: Taxation of the capital gain at the marginal tax rate of 24% in Québec and the 21.7% federal rate (with the tax abatement) and eligibility for the RRSP of the labour-sponsored funds and in the wake of the complete abolition of the federal tax credit beginning in 2017.

☐ Broaden the contribution that tax-advantaged funds make to Québec's economic development

The committee is proposing certain operational modifications to the funds to broaden their contribution to Québec's economic development. The three tax-advantaged funds have sufficient size and visibility among savers as businesses to play a wider role in supporting investments.

Recommendation 37

The committee recommends that the minimal proportion of eligible investments that the three tax-advantaged funds must make in Québec SMEs—the "investment standard"—be raised from 60% to 70%.

To give the funds the means to abide by the new standard, no ceiling on annual issues would be imposed on the labour-sponsored funds. In the case of the Fonds Capital régional et coopératif Desjardins, the total capitalization ceiling of $1.25 billion would be abolished and the fund could issue $150 million annually.

The investment standard is now set at 60%, which means that 60% of the portfolio of the tax-advantaged funds must comprise eligible investments, in particular investments in Québec SMEs.

This share for the three funds would increase from 60% to 65% in 2016-2017 and would be maintained at that level for five years. Starting in 2020-2021, the share would be increased annually by 1 percentage point such that it reaches 70% in 2024-2025. In the case of the Fonds Capital régional et coopératif Desjardins, the regional component of the investment standard would not change. The investment standard is now set at 35%.

■ Minimum holding period for shares

Recommendation 38

To afford the three tax-advantaged funds greater leeway in their investment decisions, the committee recommends that the government increase the minimum holding period for shares.

— The holding period for the two labour-sponsored funds would be increased from two years to five years.

— In the case of the Fonds Capital régional et coopératif Desjardins, it would be increased from seven years to 10 years.

The holding period adopted in respect of the labour-sponsored funds recognizes that in order to enjoy the tax benefits, the shares of the labour-sponsored funds must be held until retirement.

In the case of the Fonds Capital régional et coopératif Desjardins, the holding period corresponds to the average duration of an investment in a business.

❑ Financial impact for the government

The recommendations concerning the labour-sponsored funds would not have any financial impact for the government.

The recommendations concerning the Fonds Capital régional et coopératif Desjardins would enable the government to save $30.0 million in 2015-2016 and $7.5 million annually in the long run.

2.3 Easier business transfers between persons dealing on a non-arm's length basis

The third series of recommendations focusing on investment that the committee has formulated seeks to foster investments by facilitating transfers of businesses between persons dealing on a non-arm's length basis.

❑ The current problem

Transfers of businesses between persons dealing on a non-arm's length basis clash with a fiscal obstacle that is directly affecting the new generation of owners of SMEs.

In 2014, under the Québec and federal taxation systems, the capital gain realized through the sale of shares in a company could benefit from an $800 000 lifetime capital gain exemption, under certain conditions. In December 2014, the Québec government raised the exemption to $1 million for farm property or fishing property. It remains at $800 000 under the federal taxation system.

The exemption is intended to promote investments and to acknowledge that for the owner of an SME, an agricultural enterprise or a fishing business, the value of the SME, the agricultural enterprise or the fishing business represents the capital accumulated in anticipation of retirement.

■ The ineligibility of the lifetime capital gains exemption

The problem stems from the failure to apply the exemption when certain transfers occur of the business between its owner and a corporation dealing on a non-arm's length basis with the vendor, e.g. between a parent and his child.

Ineligibility for the lifetime capital gains exemption between taxpayers dealing on a non-arm's length basis is attributable to the need to avoid certain abuses. In the case of family businesses, it would be easy to transfer the shares and thus change ownership, thereby allowing taxable dividends to be transformed into exempted capital gains.

The question of the tax treatment of transfers of businesses between persons dealing on a non-arm's length basis therefore stems directly from the existence of the capital gains exemption, under certain conditions.

- **An irritant**

Such ineligibility is a frequently denounced irritant.[45]

Current tax rules thus favour the sale of businesses to purchasers with whom the vendors have an arm's length relationship, which can affect family business successions.

Ineligibility for the lifetime capital gains exemption of non-arm's length sales of shares penalizes the transfer of property within a family. It makes such sales less fiscally advantageous for the vendor than transfers to an arm's length person with the risk that implies for the company's survival and its continued presence in the community.

- **The committee's analysis**

The committee has analyzed this problem in order to facilitate transfers of the ownership of businesses between generations in a given family.

The problem would vanish if the lifetime capital gains exemption were replaced by an additional RRSP contribution, as the committee is proposing in its recommendations aimed at encouraging personal savings.

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[45] In particular, tax experts from Raymond Chabot Grant Thornton, an accounting firm, have often raised the question of transfers of family businesses and proposed solutions to facilitate such transfers. The authors particularly mentioned the complexity of business transfers. Given that the problem raised appears both in federal and Québec fiscal policy, their proposals are directed both at the federal government and the Québec government. See www.rcgt.com/en/news/business-transfers-report/.

☐ Three conceivable solutions

Given the impossibility of calling into question in the short term the exemption itself, three solutions are conceivable. The impossibility stems from the need for agreement with the other provinces and the federal government.

Recommendation 39

To stimulate investments by facilitating business transfers between persons dealing on a non-arm's length basis, the committee has identified three solutions that it recommends the government contemplate.

- The first solution would consist in reaching agreement with the federal government such that the sales of businesses by parents to their children through a corporation be eligible for the capital gains exemption under certain specific conditions.
- Under the second solution, Québec would intervene independently of the federal government and would remedy the situation solely in respect of Québec tax, under specific conditions.
- As for the third solution, Québec would accord all businesses the treatment now allowed agricultural enterprises or fishing businesses. Its application beyond agricultural enterprises or fishing businesses would require consultation with the federal government.

In all of the solutions identified, the committee is insisting on the importance of defining the specific tax rules for transactions genuinely related to family business successions.

■ The first solution

The first solution that the committee recommends would entail ensuring that the sale by parents to their children is indeed a transaction that transfers ownership of the business and that the children participate actively in it.

The examination of the transaction could centre on the existing "advance income tax ruling" process whereby Revenu Québec analyzes the transaction before it is carried out and confirms its eligibility or ineligibility. If the transaction is compliant, the sale of the shares would be treated as a capital gain for the vendor without the current restrictions that impose treatment in the form of a dividend.

This solution would make fully neutral the sale of a business depending on whether it is conducted through the intermediary of a corporation to the children or to a taxpayer dealing at arm's length with the vendor.

Such a solution would require an agreement with the federal government.

- ### The second solution

Through the second solution, which involves intervention by Québec independently of the federal government, Québec could qualify the transaction as a "commercial" one once it applied a verification mechanism similar to the existing advance income tax ruling process under the Québec tax regime.

Québec would thus offer a tax credit to offset the difference between the tax paid in cases where the business was sold to the children through a corporation and the tax that would have been payable in the case of a sale to a person dealing at arm's length. However, the sale to a taxpayer dealing at arm's length would continue to be advantageous because of federal taxation.

This is only a partial solution that does not compensate the difference in treatment under the Québec taxation system.

This solution also implies a significant administrative burden for the processing of files and follow-up over time. For example, a minimum holding time should be imposed after the sale as a condition to be abided by or a minimum transfer as a percentage of the shares should be contemplated.

- ### The third solution

The third solution would be of a different order. Québec would accord all businesses the treatment now allowed agricultural enterprises or fishing businesses.

In the case of such entreprises, a parent may sell directly to his child his shares at a fiscal cost below the fair market value of the business. The selling price for the vendor becomes the acquisition cost for the child.

The purpose of this provision is to facilitate the financing of the transaction for the child making the purchase, who is not necessarily paying the fair market value of the shares. Its application beyond agricultural enterprises or fishing businesses would require consultation with the federal government.

This solution would facilitate the renewed ownership of the business by a child but would not allow the parent selling the business to benefit fully from all of the potential capital gains and the attendant exemption.

❑ Administrative penalties imposed on third parties

It would be important to make provision for rules governing administrative penalties imposed on third parties.

Such rules would essentially seek to dissuade individuals who advise others to file false or misleading income tax returns in order to ensure compliance with the law.

❑ The additional cost for the Québec government

To extend the capital gains exemption realized through the sale to a child of a business would engender an additional annual cost of roughly $100 million for the Québec government. The additional cost should be assumed both in respect of the first solution and the second one.

The cost could increase significantly in the coming years since the pool of businesses likely to be sold will grow.

The committee is of the opinion that the enhancement of the amount eligible for capital gains exemption for farm property or fishing property that the government announced in December 2014 does not solve the problem of business succession. In this situation, it would be preferable to allocate the funds intended to enhance the eligible amount to the solution aimed at making eligible for the exemption the capital gains realized through the sale of a business to the owner's child.

☐ The case of farm property

Ineligibility for the lifetime capital gains exemption between taxpayers with an arm's length relationship led the committee to analyze a problem related to farm property.

The capital gains exemption applies to agricultural land. If the property has been transferred from one generation to another and even if it has already changed use, perhaps for decades, it is usually sufficient for the property to have already been used for agricultural purposes to maintain its eligibility for exemption.

Recommendation 40

In the case of the capital gains exemption for the sale of agricultural land, the committee recommends the elimination of the eligibility of farm property once it is no longer used for agricultural purposes.

A measure that was rejected: encourage entrepreneurship by means of the RRSP

Several interveners proposed to the committee that withdrawals from an RRSP be allowed to establish a business. Such a "business RRSP" would operate in a manner similar to the Home Buyers' Plan.

- An individual could thus withdraw funds from his RRSP in order to create a new business.
- The amounts would have to be repaid subsequently.

The committee's conclusion

Despite the interest of such a model, the committee has not adopted this proposal.

- First, it is emphasizing the importance of using the RRSP for the purpose of retirement savings.
- The business startup phase is especially risky. According to the Ministère du Développement économique, de l'Innovation et de l'Exportation and Statistics Canada,[1] slightly less than two-thirds of businesses survive two years after their creation and nearly one-third only survive for five years.

In this context, the committee believes that it would be too risky and contrary to the sound diversification of assets to use a portion of retirement savings to finance the creation of a business.

[1] Ministère du Développement économique, de l'Innovation et de l'Exportation, *Vers une stratégie de l'entrepreneuriat* – Guide de discussion, 2010, page 4.

A measure to avoid reviving: the Stock Savings Plan

The Stock Savings Plan II (SSP II) and the tax credit for flotation costs ended on December 31, 2014. It should be noted that since their inception, the SSP II and the tax credit for flotation costs did not achieve the anticipated success.

An array of reasons explain why the share of Québec firms in the Canadian market for initial public offerings is smaller than their economic weight, e.g. the direct costs of public offerings, recurring costs to maintain the status of the corporation listed on the stock market, the centralization of the financial sector in Toronto and the language problem, and complex, costly regulations that are scarcely adapted to SMEs.

It should also be noted that the supply of capital is abundant in Québec, which enables entrepreneurs to finance their projects by means other than initial public offerings.

The committee's conclusion

For all of these reasons, the committee has concluded that the government should neither revive the SSP II nor the tax credit for flotation costs applied to corporations.

2.4 A harmonized system for stock options awarded to employees for large businesses

The stock options awarded to employees were implemented to encourage top-tier executives to remain in their positions. In large businesses, the stock options seek to interest senior executives in the company's results since the value of the shares is readily quantifiable on the market.

Stock options do not play the same role in small enterprises or in firms not listed on the stock market. They are difficult to convert into cash and are not, therefore, directly part of the employees' remuneration.

❑ Existing tax provisions

Favourable tax provisions have been adopted to treat the taxable benefit that the value of the shares represents once the option has been exercised, i.e. the difference between the value of the share and the amount that the purchaser actually paid for it.

■ The federal government

In the case of the federal government, the provisions concerning stock options are modeled on the tax rules applicable to capital gains.

■ Québec

Between 1991 and 2002, Québec applied the same treatment to stock options as under the federal regime and in the other provinces. Since 2003, the rate of the deduction for stock options has been reduced to 25%[46] instead of 50% as is the case in the rest of Canada.

The principle invoked to justify the tax change was that we must ensure some degree of fairness with the tax treatment of employees' wages, since such wages are fully taxed. On the other hand, the inclusion rate of the capital gain is still 50%, as it is under the federal regime.

In 2008, Québec implemented a new measure. The deduction rate of stock options was once again set at 50%, in keeping with the treatment of the capital gain, solely in the case of innovative businesses with assets of less than $50 million and that are entitled to tax credits for scientific research and experimental development during the current year or the three preceding years.

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[46] The rate was first reduced from 50% to 37.5% in 2003, then from 37.5% to 25% in 2004.

The recommendation of the Task Force on the Protection of Québec Businesses

One of the recommendations of the Task Force on the Protection of Québec Businesses, established on June 7, 2013 by the Minister of Finance, was to "grant tax treatment of the gains on share call options that is more favourable than elsewhere in Canada to maximize the development of head offices and the attraction and retention of senior executives to Québec or at least harmonize such tax treatment with the other Canadian provinces."[47]

The Task Force on the Protection of Québec Businesses had a mandate to recommend measures to protect Québec firms from unwanted takeover bids and to promote the maintenance and development of head offices in Québec.

Abolish preferential treatment

As we noted earlier,[48] the committee recommends that Québec take steps with the other provinces such that the preferential treatment accorded stock options granted to employees be abolished in all of the provinces.

The reduction of the taxable benefit related to the acquisition of stock options is more or less modeled on the taxation of capital gains. Since it has been proposed in the medium term to abolish the partial inclusion of capital gains, it would be logical to also abolish the preferential treatment accorded stock options.

This coordination should be carried out within the framework of a broad discussion of the treatment of the capital gain overall, the results of which can only be anticipated in the medium term.

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[47] Task Force on the Protection of Québec Businesses, *The Maintenance and Development of Head Offices in Québec* [report], Québec, February 2014, page 46.

[48] See Recommendation 27.

☐ A solution in anticipation of the abolition of preferential treatment

However, the committee has noted, as is the case in the treatment of the capital gain in general, that it is undesirable to maintain in Québec treatment that differs from the treatment in the other provinces.

The committee has been made aware that the restrictive treatment that Québec accords risks encouraging the beneficiaries of the measures to move outside Québec.

To attain its objective from a fiscal standpoint, such a move must mean that the individuals concerned cease to be Québec residents by establishing their place of residence in another province. In such a case, Québec would lose not only the tax related to the stock options but all of the income tax payable by such taxpayers.

The committee has also noted that the treatment of stock options cannot be the same for large businesses operating as public business corporations and small enterprises incorporated as private corporations.

Recommendation 41

In the absence of agreement between all of the provincial governments concerning the abolition of the preferential treatment accorded stock options granted to employees, the committee is making the following recommendation.

In the case of public business corporations, the committee recognizes that the tax treatment of stock options is at the very root of the reasons that led to their implementation. In the current context, the committee recommends that Québec harmonize its provisions with those in force elsewhere in Canada to avoid its high-income earners from moving to the other provinces.

As for private corporations, the committee recommends the maintenance of the current treatment.

Support for angel investors

Support for the Anges Québec network

The Québec government is supporting angel investors by means of two key initiatives:

- financial assistance for the Anges Québec network to structure an exchange platform between angel investors and promising businesses that are seeking financing and guidance;
- funding for the $85-million Anges Québec Capital fund, to co-invest with angel investors in the projects of Québec firms at the seed and start-up stages operating in the information technologies and communications, life sciences, industrial technologies and innovative manufacturing sectors.

The committee believes that such support must be maintained to support Québec angel investors.

Enhancement of the rules governing the capital gains rollover

What is more, to facilitate access by small enterprises to capital the taxation system makes provision for a rule that allows an individual other than a trust to carry forward the capital gain stemming from the sale of qualifying shares in a corporation that operates a small enterprise if the proceeds from the sale are reinvested in other qualifying shares of a corporation that operates a small enterprise.

The rule appears to be rarely applied, in particular because of its complexity in respect of the qualification of qualifying shares.

The eligibility criteria governing these tax measures are harmonized with federal legislation. By way of an example, below is a partial list of the eligibility criteria:

- the book value of all of the assets of a corporation that operates an eligible small enterprise must not exceed $50 million;
- the corporation that operates a small enterprise must be a Canadian-controlled private corporation in respect of which the totality or almost the totality (90%) of the fair market value of assets is used principally in the activities of a business operated actively in Canada;
- the enterprise operated actively in Canada must have been operated mainly in Canada for a minimum of 730 days;
- the original qualifying shares must have been held for a minimum of 185 days;
- the qualifying replacement shares must have been acquired no later than 120 days after the sale of the original shares;
- the original shares and the qualifying replacement shares must be common shares;
- the shares of certain corporations are excluded, in particular professional corporations.

In order to support angel investors, the committee is of the opinion that the eligibility criteria should be reviewed and, in particular, that provision should be made to:

- extend the 120-day time limit to purchase replacement shares;
- broaden the criteria governing qualifying shares to facilitate the qualification of shares by angel investors;
- more broadly disseminate and make accessible to individuals the procedures respecting the tax measure.

Given that the measure is harmonized with federal legislation, the Québec government might initiate discussions with Ottawa to enhance the tax measure.

3. ENCOURAGE LABOUR MARKET PARTICIPATION

The work incentive is the third objective that the committee has adopted. Like the first two objectives, it is linked to economic growth and the standard of living.

However, this objective directly targets individuals: the committee wishes to encourage labour market participation through taxation that rewards effort and fosters the initiatives that individuals undertake to enter the labour market and remain there.

❑ A strategic objective in a demographic context

In the current and future demographic context in Québec, the work incentive is a strategic objective.

Québec's population is ageing rapidly, which is directly affecting economic growth, because of changes in the labour force. It is crucial for Québec to counteract the decline in the labour force by encouraging Quebecers to enter, remain on or return to the labour market.

To this end, the committee is formulating four recommendations:

— support for and the promotion of the work effort through the "tax shield," by tackling the problem of high implicit marginal tax rates;

— support for maintenance on or a return to the labour market by means of a premium for experienced workers;

— the enhancement of the work premium and the modification of the refundable tax credit for child assistance;

— non-harmonization with the federal household income-splitting measure.

3.1 Support for and the promotion of the work effort through the "tax shield": the problem of high implicit marginal tax rates

The Québec taxation system, like the federal system, offers low-income households significant assistance in the form of transfers.

Such assistance is reducible according to income, which means that when their income increases, certain taxpayers face not only higher tax payable but also a reduction in certain transfers from which they benefit. This leads to a high implicit marginal tax rate for taxpayers that fall into certain income brackets, thereby reducing the incentive to work.[49]

Recommendation 42

To tackle the problem of high implicit marginal tax rates, the committee recommends the establishment of a "tax shield" intended to reduce the implicit marginal tax rate tied to an annual increase in income.

The "tax shield" would take the form of a deduction of 50% of the increase in work income up to a maximum increase of $5 000 per household and would apply to net income, thus creating a "net adjusted income," used to calculate the following socio-fiscal tax credits:

— the work premium, including its enhancement and the new premium for experienced workers that the committee is recommending;

— the solidarity tax credit;

— the tax credit for childcare expenses.

The measure would cost **$90 million**.

The "tax shield" would thus allow households that increase their work income to protect themselves from a marked increase in their tax burden by limiting the loss of the refundable tax credits reducible according to income. It could apply each year to the increase in work income in relation to the preceding year.

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[49] For additional information, see Part 5 of Volume 3 of this report.

☐ Impact on the implicit marginal tax rate

We estimate that nearly 790 000 households could benefit from the measure, which would apply essentially to taxpayers with family incomes under $75 000.

The gains would be mainly attributable to compensation for the loss of transfers in respect of the work premium or the solidarity tax credit.

■ The example of a couple with two children

Through the "tax shield," a couple with two children could benefit from a reduction in the implicit marginal tax rate of more than 18 percentage point in certain income brackets.

If we take the example of a couple with two children and family income of $41 000 that receives the work premium, the solidarity tax credit and the tax credit for childcare expenses, in the absence of the "tax shield" and in the wake of a $1 000 increase in work income, the couple's implicit marginal tax rate would reach 61.3% without taking into account federal taxation.

By limiting the reduction of the socio-fiscal transfers from which the couple benefits, the "tax shield" would avoid unduly penalizing individuals who succeed in increasing their work income. Accordingly, under the "tax shield," the same couple's implicit marginal tax rate would fall from 61.3% to 43.0%, a reduction of 18.3 percentage points.

Possible federal government participation in the "tax shield"

The problem of implicit marginal tax rates is not confined to Québec alone. A significant part of the problem stems from the loss of socio-fiscal transfers under the federal taxation system. Accordingly, federal government participation in the "tax shield" would allow eligible households to benefit from higher compensation.

The federal measures eligible for the "tax shield" tied to the objective of encouraging Quebecers to work would be:

- the Working Income Tax Benefit;
- the GST tax credit;
- the National Child Benefit Supplement.

More specifically, the "tax shield" including the federal taxation system would enable the households affected to recover part of the reduction of such transfers. For a family with two children, this would represent an additional reduction in the implicit marginal tax rate of nearly 14 percentage points.

3.2 Continued labour market participation or a return by experienced workers to the labour market

The second way to counteract the dwindling labour force is to promote the maintenance on or a return to the labour market by workers approaching retirement or who have already retired, called experienced workers.

To this end, the committee recommends the establishment of a premium for experienced workers.

The existing tax credit for experienced workers has only a limited impact since the incentive offered is small. It applies starting at the age of 65 and is non-refundable. It seeks to offset the tax that experienced workers would have had to pay in Québec on a maximum of $4 000 of work income exceeding the first $5 000 collected.

Recommendation 43

To promote the maintenance on or a return to the labour market by workers approaching retirement or who have already retired, the committee recommends the replacement of the tax credit for experienced workers by a premium for experienced workers to be added to the work premium.

The premium would apply to work income exceeding $5 000 up to a maximum surplus income of $10 000.

The tax credit would be available at the age of 60. The rate of the tax credit would be 15% starting at the age of 60 and up to the age of 64 for a maximum tax credit of $1 500. The rate would increase to 25% starting at the age of 65, for a maximum tax credit of $2 500.

Starting with work income of $30 000, the maximum amount would be reduced by 10% for each additional dollar of work income.

The measure would have a total annual cost of **$335 million**. Bearing in mind the cost of the tax credit for experienced workers that it is replacing, the net cost of the measure would be $275 million.

The new tax credit would be a major incentive for experienced workers to remain on or return to the labour market. It would replace the existing tax credit for experienced workers.

Moreover, the premium would apply solely to work income received from taxpayers dealing at arm's length, which would avoid the experienced worker's paying himself or close relations an eligible salary instead of a dividend for the sole purpose of optimizing his tax.

❑ A new incentive for workers between 60 and 64 years of age and more generous assistance for workers 65 or over

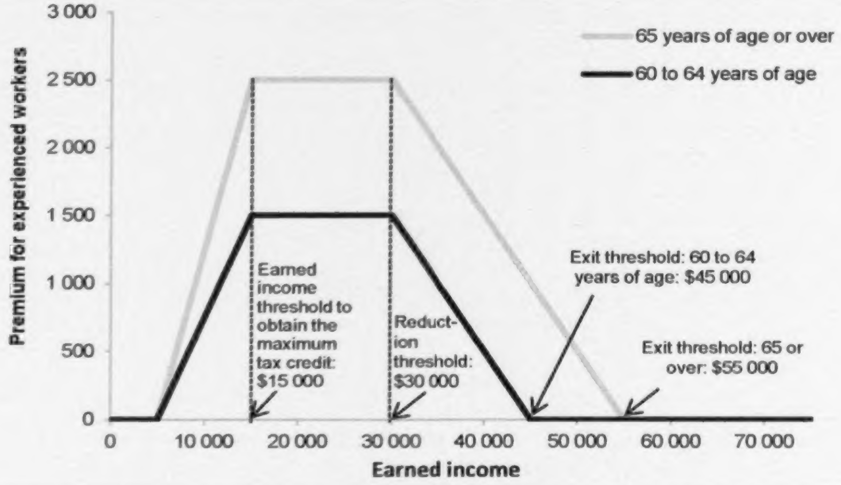
The premium for experienced workers would offer a new incentive to work for workers between 60 and 64 years of age. Indeed, such workers are ineligible for the existing tax credit for experienced workers, which is limited to individuals 65 or over. Accordingly, workers between 60 and 64 years of age are only eligible for the work premium.

Through the premium for experienced workers that the committee is recommending, they would henceforth benefit from more generous tax assistance corresponding to a rate of 15% applicable to their annual work income exceeding $5 000. The gain would stand at $750, $1 500 and $500 for individuals with work income of $10 000, $25 000 and $40 000, respectively.

For workers 65 years of age or over with annual work income between $10 000 and $45 000, the tax assistance would be more generous than the existing assistance, which could enhance the latters' incentive to work. The net tax gain, which implies the abolition of the existing tax credit for experienced workers, would in 2015 be $648, $1 898 and $398 per year for individuals with work income of $10 000, $25 000 and $45 000, respectively.

CHART 6

Illustration of the tax assistance offered by the premium for experienced workers for an eligible person living alone 60 years of age or over – 2015
($)



☐ Anticipated impact

The proposed measure would bolster the work incentive for workers 60 years of age or over who wish to remain active on the labour market by increasing disposable income by an amount of up to $1 500 for workers between 60 and 64 years of age and $2 500 in the case of workers 65 years of age or over.

■ The enhancement of implicit marginal tax rates

The premium for experienced workers would respond to the problem of the high implicit marginal tax rates observed among the beneficiaries of the guaranteed income supplement who earn work income.

Indeed, the factor that has the greatest impact on the implicit marginal tax rates of the elderly is the gradual elimination of the guaranteed income supplement, a federal government transfer aimed at reducing poverty among the elderly.

The amount of the benefits of an individual who is entitled to the guaranteed income supplement is reduced by 50 cents for each dollar of work income, excluding the old age security pension. However, there exists a $3 500 exemption for work income. Since 2011, the guaranteed income supplement has included an additional benefit for low-income earners, which is reduced by 20 cents for each dollar of income beyond the threshold of $2 000, excluding the old age security pension.

Because of their low incomes, nearly one-third of the elderly who receive the guaranteed income supplement lose half of it even if they do not pay any income tax.[50]

In the case of a worker 65 years of age or over now receiving the regular guaranteed income supplement, the new premium for experienced workers would reduce their implicit marginal tax rate by 25 percentage points for the 2015 fiscal year.

For example, if the worker earns $10 000 in annual work income, the implicit marginal tax rate would fall from 58.6% to 33.6%.

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[50] Jonathan Rhys Kesselman, *La fiscalité et l'incitation à l'épargne des ménages québécois – Document à l'intention de la Commission d'examen sur la fiscalité québécoise*, November 17, 2014.

■ Prolong work life by raising the average retirement age

Since the amounts of the premium could be substantial, its impact on the number of workers who decide to remain active on the labour market and to postpone retirement could be significant.

Furthermore, since the tax credit is refundable, the premium for experienced workers could be paid in the form of monthly advance payments, which would bolster the incentive to remain on the labour market.

The premium for experienced workers is an additional benefit when retirement is postponed

Through the tax gain obtained by means of the premium for experienced workers, a worker who decides to remain on the labour market could obtain an additional benefit in the future should he postpone the time when he starts to receive the public retirement benefits to which he is entitled.

An example

For example, a taxpayer 65 years of age who has worked all his life for the equivalent of half the maximum pensionable earnings under the Québec Pension Plan, i.e. $26 800 in 2015, would receive $23 155 each year in benefits were he to retire at 65:

- $6 765 in old age security pension;
- $6 390 from the Québec Pension Plan;
- $12 000 from an employee retirement plan.

Were the taxpayer to delay for two years his retirement, he would receive from the Québec government a premium for experienced workers of $2 500 in addition to his wages of $26 800, i.e. a total of $29 300 for each of the two years.

What is more, if he postpones for two years the payment of his public retirement benefits, the latter would increase by more than $2 000 for each year until his death in order, among other things, to compensate the shorter period during which he receives retirement benefits.

In this situation, the annual enhancement received would be:

- $974 for the old age security pension;
- $1 074 for the Québec Pension Plan benefit.

Accordingly, the taxpayer would have higher income not only for the two years of additional work but for all of the subsequent years until his death since the total amount of his benefits would increase from $23 155 to $25 203 per year.

The premium for experienced workers reflects foreign initiatives

A number of researchers have highlighted factors that discourage work to which experienced workers may be subject. Various research findings suggest that a measure such as the one that the committee is proposing could have a positive impact in this respect. Australia, the Netherlands and Sweden apply tax provisions akin to the premium that the committee is proposing.

In the 1990s, research conducted in various countries showed that financial incentives can influence whether or not workers decide to remain on the labour market.[51] Canadian researchers have also shown that the financial provisions in the Canadian taxation system that discourage work appear to have a negative impact on retirement age.[52]

Other studies have shown that lower clawback rates in respect of certain benefits paid to the elderly have a positive impact on their participation in the labour market in Canada, the United States and the United Kingdom.[53]

Lastly, in a report focusing on employment and taxation, the OECD concludes that the tax system has a significant impact on the work-related decisions of the elderly.[54] In its report, the OECD suggests different avenues to enhance the tax system in this respect, including the introduction of a tax credit.

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[51] Jonathan Gruber and David A. Wise, *Social Security and Retirement around the World*, The University of Chicago Press, National Bureau of Economic Research, 1999.

[52] Michael Baker, Jonathan Gruber, and Keven Milligan, "The Retirement Incentive Effects of Canada's Income Security Programs" in *Canadian Journal of Economics*, Vol. 36, No. 2, 2003, pages 261-290.

[53] Michael Baker and Dwayne Benjamin, "How Do Retirement Tests Affect the Labour Supply of Older Men?" in *Journal of Public Economics*, Vol. 71, No. 1, 1999, pages 27-52; Steven Haider and David S. Loughran, "The Effect of the Social Security Earnings Test on Male Labor Supply – New Evidence from Survey and Administrative Data" in *Journal of Human Resources*, 2008, Vol. 43, No. 1, pages 57-87; Richard Disney and Sarah Smith, "The Labour Supply Effect of the Abolition of the Earnings Rule for Older Workers in the United Kingdom" in *The Economic Journal*, Vol. 112, No. 478, 2002, pages 136-152. See also the research of Alexandre Laurin and Finn Poschmann, "Que sont devenus les taux effectifs marginaux d'imposition des Québécois?" in *Cyberbulletin*, C. D. Howe Institute, and that of Keven Milligan and Tammy Schirle, "Improving the Labour Market Incentives of Canada's Public Pensions" in *Canadian Public Policy*, Vol. 34, No. 3, 2008, pages 281-303.

[54] OECD, *Taxation and Employment – OECD Tax Policy Studies*, No. 21, OECD Publication, 2011.

Some initiatives to encourage experienced workers in certain OECD countries

Different countries have implemented initiatives to encourage experienced workers to remain on or return to the labour market. The committee has selected several examples.

Australia

Australia offers a non-refundable tax credit to the elderly 55 years of age or over who earn income from remunerated work. The credit is equivalent to 5% of the first AUD$10 000 of work income, i.e. roughly CAD$9 800, for a maximum of AUD$500.

Starting on work income of AUD$53 000, i.e. roughly CAD$52 000, the credit is reducible according to income.

The Netherlands

The Netherlands also offers a tax credit for workers 61 years of age or over. The credit is offered to individuals with work income of at least €8 860, i.e. roughly CAD$12 300.

The tax credit varies according to age: it is 5%, 7% and 10% for elderly people 61, 62 and 63 years of age, respectively. The amounts of the credit paid may not exceed €2 296, €3 214 and €4 592 for elderly people 61, 62 and 63 years of age, respectively. The maximums are reached when work income totals €54 776, i.e. roughly CAD$76 000.

In the case of individuals 64 years of age or over, the credit is less generous, both from the standpoint of the rate and the maximum amounts.

The tax credit for elderly workers is not reducible according to income.

Sweden

In Sweden, the non-refundable credit on work income is more generous for individuals aged 65 years or over. The amount of the credit is complex to determine: not only does the rate of the credit vary according to income but also the base amount used to calculate the credit depends on the amount of certain transfers received. The credit corresponds to roughly 10% of the first 300 000 Swedish kronor of work income, i.e. roughly CAD$44 000.

As is the case in the Netherlands, the credit is not reducible according to income.

Note: Currency conversions in Canadian dollars were made at the rate in force in January 2015.
Source: OECD, *Taxation and Employment – OECD Tax Policy Studies*, No. 21, OECD Publication, 2011.

3.3 Encourage maintenance on or a return to the labour market: the enhancement of the work premium and the modification of the refundable tax credit for child assistance

Low- or middle-income workers can benefit from a work premium in the form of a refundable tax credit.

☐ The work premium

At present, the work premium that is intended for households not subject to any serious constraint to employment applies to work income exceeding $2 400 for a household with only one adult and $3 600 for a household comprising two adults.

The supplementation rates for work income are 7% for persons living alone and childless couples, 25% for couples with children, and 30% for a single-parent family, up to a certain maximum.

Since the work premium is integrated into last resort assistance, the amount of the premium reaches a maximum at the income threshold at which a household that is able to work is no longer eligible for last resort assistance, i.e. $10 370 in the case of a person living alone and $10 056 for a household comprising two adults.

Accordingly, in 2015 the maximum amounts of the premium are $558, $872, $2 391 and $3 114 $, respectively, for a person living alone, a childless couple, a single-parent family and a couple with children.

❑ The proposed enhancement

Recommendation 44

To further reward the work effort and bolster incentives to integrate the labour market, the committee recommends the enhancement of the work premium.

The supplementation rate of the work premium for households without serious employment limitations would be increased by 2 percentage points for childless households and by 2.5 percentage points for households with children. The supplementation rates for work income would thus be 9% for persons living alone and childless couples, 27.5% for couples with children, and 32.5% for a single-parent family.

A similar enhancement of the supplementation rate would be applied to a household in which there is one adult with serious employment limitations.

The work premium would continue to be reducible according to family income subject to a benefit recapture rate of 10% for each dollar of income that exceeds the applicable income threshold, depending on the type of household. The reduction points would remain the same.

This recommendation would have a total cost of **$107 million**.

The increase in the supplementation rates that the committee is proposing would raise the maximum amounts of the premium in 2015 to $717, $1,121, $2 590 and $3 425, respectively, for a person living alone, a childless couple, a single-parent family and a couple with children.

The enhancement that the committee is proposing would significantly affect household disposable income. The gains could reach more than $300 for a couple with two children and more than $150 for a person living alone. The enhancement of the work premium would benefit the most disadvantaged.

☐ Changes to the refundable tax credit for child assistance linked to the enhancement of the work premium

To avoid subjecting low- or middle-income families with children to overly high implicit marginal tax rates, the child assistance measures and the work premium are being integrated.

As is the case for the work premium, the refundable tax credit for child assistance is reducible according to income. The income threshold at which the work premium becomes null is equivalent to the threshold at which the refundable tax credit for child assistance becomes reducible according to income. In 2015, the amounts stand at $34 280 for a single-parent family and $47 196 for a couple with children.

The tax credit for child assistance includes a universal component: beyond a certain threshold, the government pays a minimum amount per child to all eligible families.

Recommendation 45

In conjunction with the enhancement of the work premium, the committee recommends that the income thresholds at which the tax credit for child assistance becomes reducible according to income be increased from $34 280 to $36 273 for a single-parent family and from $47 196 to $50 310 for a couple with children.

In addition to this modification, the committee recommends that the clawback rate on the amounts paid pursuant to the refundable tax credit for child assistance decrease from 4% to 3%.

Moreover, the committee recommends that the universal portion of the credit be eliminated. Couples with two children and incomes of nearly $170 000 would no longer receive any amount under the tax credit for child assistance.

The recommendation would have a net cost of **$6 million**.

The committee is, therefore, proposing that a portion of the amounts paid to well-to-do families under the refundable tax credit for child assistance be reallocated to families with lower incomes.

A number of families would thus receive higher amounts of child assistance and their implicit marginal tax rate would be reduced by 1 percentage point.

Examples of increases in disposable income that accrue to families with children

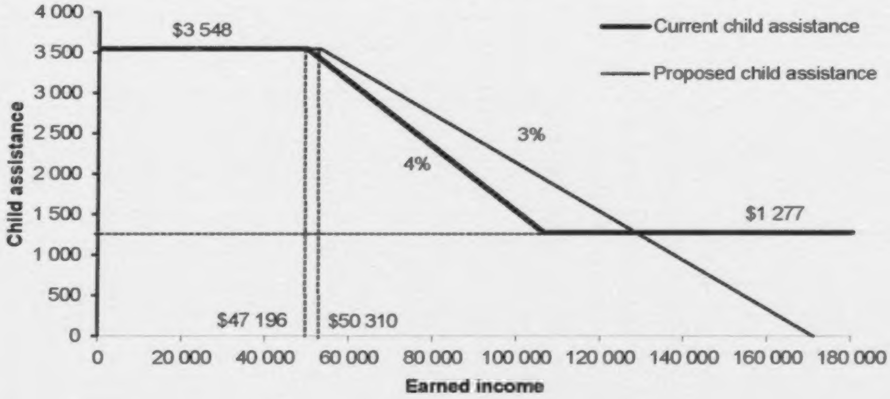
A couple with two children earning $50 000 in work income would receive $225 more per year in the form of the work premium and an additional $23 in child assistance solely because the income threshold at which child assistance becomes reducible according to income would be raised.

In the case of a couple with two children and income of $70 000, the clawback rate of the tax credit for child assistance would fall from 4% to 3% and the couple would receive an additional $299 in child assistance.

A single-parent family with one child earning $30 000 in work income would receive $199 more per year in the form of the work premium and $0 more in child assistance solely because the income threshold at which child assistance becomes reducible according to income would be raised for a cumulative gain of $199.

In cases where the income of a single-parent family with one child was $50 000, with the reduction from 4% to 3% in the clawback rate of the credit, the family would receive $206 more in child assistance.

An illustration of child assistance for a couple with two children and two equal incomes
($)



3.4 The federal household income-splitting measure

Under the Québec taxation system and the federal tax regime, the members of a family may not usually split work income.

On October 30, 2014, the federal government announced that it would allow spouses to split work income in families with minor children. This approach is a disincentive to work, unlike the approach that Québec has adopted. Indeed, in certain situations, allowing a high-income earner to transfer income to a spouse with no or little income may discourage the latter from returning to the labour market.

Québec policies, in particular reduced-contribution childcare services and the Québec Parental Insurance Plan, promote participation by both parents on the labour market. For these reasons, Québec should avoid this type of measure.

Recommendation 46

The committee recommends that the Québec government not harmonize itself with the federal household income-splitting measure.

The federal income-splitting measure for families

The logic underlying income-splitting is to allow a high-income earner to transfer part of his or her income to the spouse with a lower tax rate. The bigger the income gap, the bigger the marginal tax rate gap is and the bigger the tax savings will be.

Income-splitting allows a low-income earner to fully benefit from non-refundable, non-transferable tax credits by paying tax instead of the spouse with a higher income.

Families with the biggest income gaps benefit the most from income-splitting. Indeed, income-splitting is hardly advantageous for spouses whose family income is low and for households in which the income gap between the spouses is small.

Changes in the federal initiative

The federal government initially contemplated maximum income-splitting up to a maximum of $50 000 in work income between spouses. Such income-splitting would have achieved much more substantial tax savings for certain families and affected the taxes of certain provinces, which aroused criticism.

The measure announced takes the form of an annual tax credit equivalent to the federal tax reduction that would result from the transfer of a maximum of $50 000 in taxable income from one spouse to the other, for a maximum credit of $2 000.

4. ENCOURAGE PERSONAL SAVINGS

The fourth objective that the committee has formulated concerns **personal savings**, which must be **encouraged**. This objective stems directly from one facet of the mandate that the government assigned to the committee.

Personal savings are an important question. Individuals must save to cope with unforeseen events, finance major projects and prepare for retirement. The responsibilities to be assumed to this end are less and less collective. We must observe that in this context the level of personal savings is often inadequate.

Taxation directly affects the choice that individuals make between immediate consumption and savings in anticipation of future consumption.

Certain recommendations presented earlier pursue this objective. This is true of the revision of the tax mix that the committee is proposing, which would promote personal savings. Lower income tax combined with higher consumption taxes encourage saving. Indeed, taxation based on consumption is deemed to be more favourable to saving than taxation centred on income.

To encourage more extensive personal savings, the committee recommends that the government:

— make better use of existing tax tools as regards saving;

— pursue support for tax-advantaged funds, under certain conditions;

— replace the lifetime capital gains exemption with an additional RRSP contribution.

4.1 Make better use of existing tax tools as regards saving

The existing tax system already offers numerous saving incentives, in particular through the registered retirement savings plan (RRSP) and the tax-free savings account (TFSA). The Home Buyers' Plan also allows savers, under certain conditions, to use funds invested in their RRSP to purchase their first home, in addition to the array of tax measures offered to encourage saving.

☐ No additional tax measures

The committee acknowledges that tax incentives geared to saving are not the main factor that affects individual decisions to save.

Recent research in the realm of behavioural economics offers numerous convincing findings that confirm the importance of psychological factors in savers' choices. In particular, the manner in which savings options are presented to potential savers significantly affects the choices that they make.

For example, simplified mechanisms to adhere to retirement savings vehicles can do a great deal to encourage individuals to make the best choices. The process of automatic enrolment by default under the new voluntary retirement savings plan (VRSP) draws inspiration from this approach.

Government financial education initiatives aimed at broadening knowledge and practices with respect to financial questions could play a more significant role than tax measures to influence behaviour and lead to more enlightened choices concerning personal savings.

The committee believes that encouragement of saving does not hinge on additional tax measures but instead on:

— better oversight of the use of the RRSP, a tax tool, by ensuring that it is used for retirement;

— broader overall coherence between the existing tax tools, through the initiation of Canada-wide discussions.

An adequate home ownership measure

The Home Buyers' Plan allows savers, under certain conditions, to use funds invested in their RRSP to purchase their first home. This tool seems to full satisfy the needs for which it was intended.

The committee does not believe that there is reason to modify its parameters or to add other incentives.[1]

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[1] Jonathan Rhys Kesselman, *La fiscalité et l'incitation à l'épargne des ménages québécois – Document à l'intention de la Commission d'examen sur la fiscalité québécoise*, November 17, 2014.

Ensure that RRSPs are used for retirement

The RRSP is, overall, a sound retirement savings measure. At present, the funds deposited in an RRSP may be withdrawn at any time, regardless of age, and are simply taxable at the time of withdrawal.

Impose a penalty

The possibility of withdrawing funds without penalty may undermine preparation for retirement. In cases where individuals withdraw funds to cope with difficult circumstances, premature withdrawals may be warranted. On the other hand, under other circumstances, such withdrawals may lead to poor financial planning.

While individuals appear to take into account the costs and benefits of their short-, medium- and long-term actions, in point of fact they often tend to overestimate the consequences of their short-term gestures. Recent research in the realm of behavioural economics offers proof in this respect.

Against this background, mechanisms that create for savers incentives to abide by their commitments and intentions in relation to their financial planning for retirement could enhance decision-making. Recent empirical studies on the topic tend to reveal that such mechanisms do not discourage saving. The opposite appears to be true.

Recommendation 47

To ensure that funds saved in an RRSP are used, first and foremost, for retirement, the committee recommends that a penalty of up to 10% be levied when funds are withdrawn from an RRSP before the age of 55, except under certain specific circumstances.

The committee also recommends that the deduction at source be changed to the maximum tax rate for any withdrawal before the age of 55 in order to discourage such withdrawals.

Exceptions to the penalty

Certain exceptions should apply to the proposed penalty to take into account events that may arise during an individual's lifetime that lead to serious financial difficulties.

This is true, for example, of a severe or prolonged disability that leads to permanent unemployability, death, serious, irreversible illness, or a disaster involving the principal residence. What is more, such circumstances are recognized in the provisions governing procedures for withdrawing funds invested in tax-advantaged funds such as the Fonds de solidarité de la FTQ.

The withdrawals allowed under the Home Buyers' Plan and the Lifelong Learning Plan would continue to apply under the same conditions.

The penalty should be paid when the funds are withdrawn, at the same time as the deduction at source already stipulated in such cases.

Deductions at source

Withdrawals from RRSPs are subject to tax deductions at source and the deduction rates applied depend on the amount of the withdrawal requested.

— Withdrawals of $5 000 or less are subject to a 10% rate for federal income tax, which rises to 20% for amounts ranging from $5 000 to $15 000, and to 30% for any amount greater than $15 000.

— To the federal deduction rate is added the Québec rate of 16%, corresponding to the lowest rate on the tax rate schedule. The rate applies irrespective of the amount of the withdrawals.

As for the proposed change to the deduction at source—the shift to the maximum tax rate for all withdrawals before the age of 55 to dissuade such withdrawals—Québec could establish such a measure without harmonization with the federal government.

Should a deduction or a credit be allowed in respect of contributions to an RRSP and a registered pension plan?

The deduction for contributions to a registered retirement savings plan (RRSP) or a registered pension plan, like any other deduction, affords a bigger advantage to individuals with higher incomes, because of the progressivity of the tax.

On the other hand, a tax credit reduces the tax payable by an equivalent amount for everyone, regardless of income.

The study conducted for the committee

In a study conducted for the committee, Suzie St-Cerny[1] shows, indeed, that the lowest income groups benefit less from tax measures to promote saving for retirement than groups with higher incomes.

The committee finds unwarranted the conversion of the deduction into a credit

The committee has examined the merits of converting the deduction for contributions to an RRSP or a registered pension plan into a tax credit and deems such a change to be unwarranted since it would impair the coherence of the tax measures.

Indeed, since subsequent withdrawals from RRSPs and the funds received from a registered pension plan are subject to tax at the tax rate applicable to the taxpayer when the funds are withdrawn, the principle of the simple carry forward of the tax inherent in the existing tax measure would be compromised.

The committee's recommendation hinges, in particular, on the arguments put forward by Jonathan Rhys Kesselman[2] in a study produced for the committee that provides a thorough analysis of the provisions under the federal and Québec taxation systems devoted to saving and asset accumulation. The author also takes the view that it would be unadvisable to convert the deduction into a tax credit.

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[1] See Suzie St-Cerny, *Impôts sur le revenu des particuliers au Québec : Qui profite le plus des déductions et des crédits?*, Research Chair in Taxation and Public Finance, Université de Sherbrooke, October 2014, in Volume 5 of this report.

[2] Jonathan Rhys Kesselman, *La fiscalité et l'incitation à l'épargne des ménages québécois – Document à l'intention de la Commission d'examen sur la fiscalité québécoise*, November 17, 2014.

❑ Initiate a Canada-wide discussion on the coherence of tax tools that encourage saving

Aside from the registered pension plans of employers, the RRSP and the TFSA are the main fiscal vehicles to encourage saving. Both savings vehicles operate in a parallel manner with two distinct incentives.

— The RRSP, examined earlier, is a tax deferral system.

— The TFSA is a zero-rating system for returns since it allows the payment of non-deductible funds into an account in which investment income and withdrawals are entirely tax free.

Since 2009, the contribution room to the TFSA has stood at $5 000 per year, indexed in $500 increments. The maximum annual contribution was set at $5 000 from 2009 to 2012 and has stood at $5 500 since 2013. Over the years, saving, on which interest and returns are thus non-taxable, will become significant in scope.

Recommendation 48

The committee recommends that Québec, in collaboration with the federal government and the provinces, engage in reflection to better match the RRSP and the TFSA and thereby enhance the overall coherence of saving incentives.

Such reflection should, in particular, focus on:

— the contribution ceiling in each regime, in particular the TFSA, which might be limited to a certain lifetime amount, e.g. $100 000;

— the coordination of contributions to either regime, e.g. through the imposition of a common ceiling;

— the impact of either regime on the benefits paid under the guaranteed income supplement program.

Indeed, an RRSP withdrawal reduces the amount of the guaranteed income supplement to which a low-income earner may be entitled. The RRSP is not necessarily the best savings vehicles for an individual who is entitled to the guaranteed income supplement. The TFSA could prove to be a better planning tool.

The taxation of interest and the normal return on savings and the TSFA

The taxation of income without special provisions to promote saving means that the taxpayer must pay tax not only on the proceeds of his work but also on investment income generated by the portion of his work income that he has saved, which can be deemed "double economic taxation."

By allowing, in particular, the avoidance of taxing the inflation component in savings returns, the TFSA is a sound means of saving for short-term needs.

4.2 Continued support for tax-advantaged funds

We examined the question of tax-advantaged funds earlier with the stimulation of business investment. We must also refer to them here since they are a significant incentive to saving for retirement.

Each year, out of 1.5 million contributors to an RRSP, roughly 300 000 individuals, i.e. 20%, contribute to labour-sponsored funds.[55] For more than one-third of the shareholders of the Fonds de solidarité FTQ, the purchase of shares in the fund constituted their first RRSP investment. Some 80% of them subsequently purchases another RRSP product.

The labour-sponsored funds contributed to the establishment of group registered retirement savings plans (GRRSPs) or deduction at source programs in nearly 6 500 businesses in Québec.[56] As of May 31, 2014, the Fonds de solidarité FTQ and Fondaction had just over 600 000 shareholders and nearly 130 000 shareholders, respectively.[57]

The Fonds Capital régional et coopératif Desjardins had just over 100 000 shareholders as of December 31, 2013.

The recommendations that the committee formulated earlier to ensure equivalent fiscal profitability between the tax-advantaged funds and increase the contribution of the funds to Québec's economic development would confirm and strengthen the role that the tax-advantaged funds play in respect of personal savings.[58]

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[55] Ministère des Finances du Québec, *Budget 2012-2013 – Quebecers and Their Retirement: Accessible Plans for All* [document], March 2012.

[56] Fonds de solidarité FTQ, *Le Fonds de solidarité FTQ : une solution aux enjeux d'épargne et d'investissement plus pertinente que jamais*, brief submitted to the Québec Taxation Review Committee, October 9, 2014.

[57] Fonds de solidarité FTQ, *L'annuel 2014 – Rapport annuel et de développement durable*, May 31, 2014, and Fondaction, *Donner du sens à L'argent – Rapport annuel 2013-2014*, 3rd quarter, 2014.

[58] Recommendations 35, 36, 37 and 38.

4.3 The replacement of the lifetime capital gains exemption by an additional RRSP contribution

The committee examined earlier the rules that stipulate the lifetime capital gains exemption from the standpoint of the different treatment accorded arm's length share transfers.

The Canadian taxation system includes a lifetime capital gains exemption of $800 000 realized through the sale of the shares of a company. In the case of the Québec taxation system, the exemption is the same except for farm property and fishing property, in respect of which it is $1 million.

The exemption is intended to recognize that for the owner of an SME, the value of his enterprise constitutes the capital that will enable him to finance his retirement.

☐ An inappropriate way to encourage saving for retirement

The committee is of the opinion that the lifetime capital gains exemption is not an appropriate way to encourage personal savings for retirement.

The exemption is often used for purposes other than preparation for retirement. Tax planning, in particular by means of trusts, are set up to multiply the use of this exemption in a family or a group of persons dealing on a non-arm's length basis.

☐ The committee's recommendation

As indicated earlier, the committee recommends that the existing lifetime capital gains exemption be replaced by an additional contribution to the RRSP in order to directly foster saving for retirement.[59] The government would better respond to the exemption's rationale, i.e. the preparation for retirement of the vendor.

The additional RRSP contribution would be linked to the holding period of the enterprise.

Accordingly, at the time of sale of the shares of a corporation, a farm property or a fishing property, the vendor could tax himself on the gain or contribute to his RRSP or to a registered retirement income fund (RRIF) an amount equivalent to the maximum annual RRSP contribution multiplied by the number of years that he has held the enterprise.

Québec could not implement on its own this recommendation, the application of which would require an agreement with the federal government.

The gains stemming from the sale would not be taxable on the earnings transferred to the RRSP. This contribution would not, therefore, entitle the individual to an additional deduction since the amount transferred is not taxable.

What is more, the contribution would not affect the accumulated contribution room.

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[59] See recommendation 26.

The proposed rules

The lifetime maximum amount to be contributed should be $400 000, indexed for inflation, if we want to offer at the time of sale the same tax benefit as the existing $800 000 exemption at the 50% inclusion rate.

The amount should be $500 000, indexed for inflation, in the case of farm property or fishing property, to take into account the new exemption ceiling that the Québec government defined in December 2014.

The application of this recommendation would not engender any additional cost but ultimately a saving for the government: the taxation of the gain would be carried forward over time instead of being non-existent.

It must be emphasized that the replacement of the lifetime capital gains exemption by an additional RRSP contribution would have a positive impact by halting certain planning schemes that hinge on the multiplication of the use of the capital gains exemption.

A recommendation already formulated in the past

Moreover, this recommendation has already been formulated in the past.

The *Report of the Technical Committee on Business Taxation* published in 1997 by the Department of Finance Canada [60] proposed:

- the elimination of the lifetime capital gains exemption on farm property and the qualifying shares of corporations operating a small enterprise;
- the replacement of the exemption by an enhanced RRSP contribution system that would enable taxpayers to use taxable capital gains on farm property and the qualifying shares of small enterprises to increase their contribution room to the RRSP in previous years.

In Québec, a recommendation along the same lines appeared in the report of the Commission on Taxation and the Financing of Public Services published in 1996.[61]

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[60] Technical Committee on Business Taxation, *Report of the Technical Committee on Business Taxation*, Department of Finance Canada, 1997, pages 7-20.

[61] Commission on Taxation and the Financing of Public Services, *Working Together for a Responsible Québec –Report of the Commission on Taxation and the Financing of Public Servcies*, Gouvernement du Québec, 1996, page 84.

5. ADHERE TO SUSTAINABLE DEVELOPMENT

The fifth objective that the committee has adopted is **to conduct tax reform in the perspective of sustainable development**.

Like all jurisdictions, Québec is concerned by sustainable development, a truly worldwide challenge. By acting in respect of economic players, taxation is a key means of internalizing the economic, social and environmental facets of sustainable development.

By selecting this objective, the committee is clearly indicating its awareness of the question and its intention to propose a tax reform that reflects the importance that it attaches to this challenge.

❑ The concept of eco-taxation

Sustainable development and taxation converge in a concept commonly called eco-taxation.

The committee has noted that environment-related taxes are becoming increasingly important among the economic instruments that the large industrialized nations use. Eco-taxation seeks to influence prices through taxes to limit the consumption of goods or activities that engender negative externalities such as pollution and traffic congestion, according to the user pay principle or the polluter pays principle.

The user pay principle is one of the principles found in the Québec *Sustainable Development Act* and also appears in the Québec *Environment Quality Act*.

The committee is of the opinion that, to remedy market failures, eco-taxation has advantages that regulations do not. It makes it possible to internalize negative externalities in the price of a good or service. It increases government revenues. It can enhance economic efficiency, in particular if the revenues drawn from eco-taxation lead to lower income tax.

Eco-taxation affects a wide range of fields including transportation, management of residual material and land-use planning, fields that we were unable to analyze in detail within the prescribed time. Eco-taxation's complexity led the committee to limit the number of its short-term recommendations to four fields of intervention.

❑ The committee's proposals

The committee is proposing to:

- increase the additional motor vehicle registration fee demanded on luxury vehicles;
- increase the fuel tax on gasoline and diesel;
- increase the price of heritage pool electricity within the framework of Hydro-Québec's rating and levy a tax on overconsumption of electricity in the household sector;
- engage in long-term reflection on the application of eco-taxation and the application of the user pay principle.

5.1 Increase the additional motor vehicle registration fee demanded on luxury vehicles

The committee recommends that the additional motor vehicle registration fee demanded on luxury vehicles be increased.

It recommends that electric vehicles, regardless of price, be exempt to bolster the ecofiscal nature of the fee.

This recommendation was already presented earlier, with the modifications proposed concerning consumption taxes.[62]

In the December 2014 *Update on Québec's Economic and Financial Situation*, the government announced an increase in the additional fees on vehicles equipped with high displacement engines. The committee supports this increase, which is in keeping with the logic of sustainable development.

Considering the recent increase, the committee does not recommend an additional increase in the motor vehicle registration fee on vehicles equipped with high displacement engines.

☐ The additional motor vehicle registration fee demanded on luxury vehicles

An additional motor vehicle registration fee is also levied on luxury vehicles. The additional fee acts as a luxury tax but also constitutes a form of eco-taxation. Indeed, luxury vehicles usually consume more fuel.

The committee recommends that the additional fee be increased by raising its rate from:

- 1% to 2% on the value exceeding $50 000, up to $60 000;
- 1% to 3% on the value exceeding $60 000;

The existing 1% rate would continue to apply to the value exceeding $40 000, up to $50 000. This modification would generate $11 million annually in additional revenues for the government.

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[62] See Recommendation 15.

5.2 The increase in the fuel tax on gasoline and diesel

Gasoline used for transportation is a significant source of greenhouse gases. Transportation by automobile also engenders traffic congestion problems whose economic consequences are considerable.

These negative externalities warrant levying significant taxation to change behaviour

As indicated earlier,[63] the committee recommends an additional annual 1-cent-per-litre increase in the fuel tax on gasoline and diesel for five years to send a clear signal in favour of reduced consumption and allow taxpayers time to adapt.

In the long run, the recommendation would generate $600 million in tax revenues annually and would complement the anticipated impact of the application of the GHG emission cap-and-trade system.

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[63] See recommendation 14.

The GHG emission cap-and-trade system

The GHG emission cap-and-trade system is a flexible market mechanism used to induce a carbon cost and promote the adoption of clean technologies.

The most efficient businesses that reduce their greenhouse gas emissions below their rights may sell the surplus on the carbon market, thus enabling them to wholly or partially recover the cost of their investments.

The businesses whose greenhouse gas emissions exceed their rights may choose to invest in green technologies or purchase rights.

Two phases

The implementation of the GHG emission cap-and-trade system was planned in two compliance phases. Accordingly, enterprises that emit more than 25 kilotonnes of CO_2 equivalent have had to offset their greenhouse gas emissions by means of rights under the GHG emission cap-and-trade system:

- since 2013 for the industrial sector and electricity generation;
- since 2015 for fuel and fossil fuel distributors.

Since the cost of the rights purchased by distributors could be passed on to their customers, it could have an impact on the price of fuel and fossil fuels in 2015. The new system will replace the royalty on fossil fuels, which ended on December 31, 2014.[1]

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[1] Until December 31, 2014, the Régie de l'énergie collected from fossil fuel distributors a royalty on fossil fuels. The royalty, set at $4.26 per tonne of CO_2, is estimated at $164.5 million in 2014.

5.3 The increase in the price of heritage pool electricity within the framework of Hydro-Québec's rating and the levying of a tax on overconsumption of electricity in the household sector

Québec benefits from electricity rates that are lower than in most other jurisdictions. The low rates are advantageous for consumers.

They nonetheless imply lower revenues for the government which is Hydro-Québec's sole shareholder, in addition to failing to encourage reduced consumption.

The committee has formulated two recommendations concerning electricity rates in Québec that generate additional revenues:

- increase by 0.8 cent per kilowatt-hour the cost of heritage pool electricity, equivalent to a 1-cent- per-kilowatt-hour increase on average for the clientele overall, with the exception of the large power industrial ("L") rate;
- levy a tax on overconsumption of electricity.

☐ Increase by 0.8 cent per kilowatt-hour the cost of heritage pool electricity

The cost of heritage pool electricity set by the government is used to calculate the electricity rates that consumers pay. The price is now indexed annually and the value of the indexation is paid into the Generations Fund.

Recommendation 49

The committee recommends that the cost of heritage pool electricity be increased by 0.8 cent per kilowatt-hour over two years and that its indexation be maintained subsequently.

The additional revenues generated by the increase would be used to fund the committee's proposed tax reform by using the funds generated for individuals and corporations, respectively.

The revenues stemming from the indexation would continue to be paid into the Generations Fund.

This measure would generate total annual revenues of **$1.123 billion**:

— **$623 million** among individual consumers;

— **$500 million** among corporations.

In the past, large industrial customers paying the "L" rate were not subject to the indexation of the cost of heritage pool electricity. Assuming that such customers are also exempt from the proposed increase, the average rate increase would stand at roughly 1.0 cent per kilowatt-hour (kWh) for the other customers overall.

In the long run, the measure would have a limited impact on household customers.

❑ Levy a tax on overconsumption of electricity in the household sector

The low cost of electricity in Québec hardly encourages energy conservation and better control over consumption.

Recommendation 50

The committee recommends that a 10% tax be levied on overconsumption of average household electricity exceeding 80 kilowatt-hours per day.

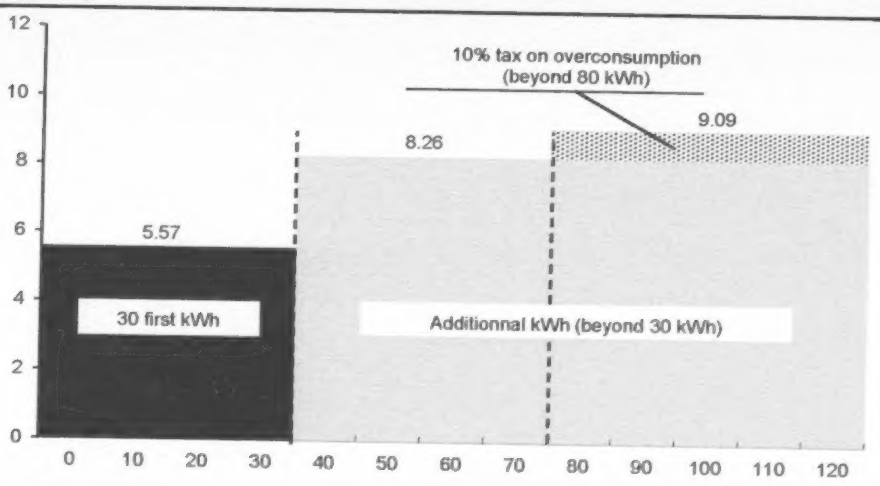
The measure would generate **$82 million** annually.

The implementation of this tax on overconsumption of electricity exceeding 80 kWh per day on average would raise the cost of consumption from 8.26¢/kWh to 9.09¢/kWh for this consumption bracket. The tax would be added to Hydro-Québec's rate and would not be a new rate.

It would affect the household consumers who consume the most electricity. It would not affect individuals living in a five-and-a-half-room dwelling unit.

CHART 7

Structure of the household electricity rate – With the 10% overconsumption tax
(in cents per kWh)



Note: The rate in effect on April 1, 2014, to which is added the daily charge of 40.64 cents.

The household electricity rate

The existing structure

At present, household electricity consumers pay a 40.64¢ per day fixed charge. The next 30 kWh per day are then billed at 5.57¢/kWh and the remaining energy is billed at 8.26¢/kWh.

The impact of the proposed changes

All told, for household customers, the combination of the tax on overconsumption and the impact of the rise in the cost of heritage pool electricity would increase, on average, the average annual electricity bill by:

- $108 for a five-and-a-half-room dwelling unit;
- $204 for a small house;
- $293 for an average-sized house;
- $664 for a large house.

Summary of the proposed measures for residential customers

	Average price (¢/kWh)		Average annual bill ($)			
					Difference	
Type of dwelling[1]	**Before the measure**	**After the measure**	**Before the measure**	**After the measure**	**In $**	**As a %**
Five-and-a-half-room dwelling unit	7.37	8.33	854	962	108	12.6%
Small house	7.60	8.63	1 557	1 761	204	13.1%
Average-sized house	7.71	8.85	2 042	2 335	293	14.4%
Large house	7.96	9.37	3 824	4 488	664	17.4%

(1) According to the typical cases presented in Hydro-Québec's 2015-2016 rate application.
Source: Hydro-Québec estimates.

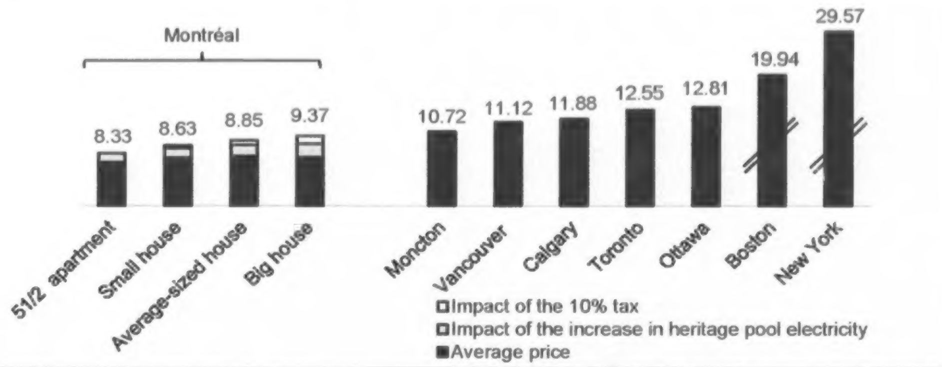
The household electricity rate (continued)

Despite the two proposed measures, the household rate remains competitive

By combining the two measures concerning the residential sector that the committee is proposing, the price of electricity in Québec would remain lower than elsewhere.

Despite the measures, average household electricity prices in Montréal are the lowest. For example, after the application of the measures, the average price of electricity for a large house in Montréal would be 9.37¢/kWh, compared with 12.81¢/kWh in Ottawa.

Average household electricity prices in Montréal (after the measures) and in city large North American cities
(in ¢/kWh)



Note: The changes are based on annual consumption by type of dwelling: 11 590 kWh for a five-and-a-half-room dwelling unit (966 kWh per month), 20 494 kWh for a small house (1 708 kWh per month), 26 484 kWh for an average-sized house (2 207 kWh per month) and 48 062 kWh for a large house (4 005 kWh per month).

5.4 Better integration of the principles of eco-taxation

Recommendation 51

The committee recommends that Québec better integrate the principles of sustainable development through eco-taxation and the application of the user pay principle or the polluter pays principle.

To this end, the committee recommends that the government closely monitor research and experience in the realm of eco-taxation both abroad and in Canada and Québec to collect as much information as possible to maximize the benefits that Québec society could derive from such taxation.

Some of the changes demand reflection and more thorough discussion. The definition of the new energy policy that the government has announced affords a significant opportunity to undertake such reflection.

☐ Electricity rates that vary depending on the time of day

One worthwhile avenue to explore is electricity rates that vary depending on the time of day.

Time-of-use rates vary the cost of the electricity consumed depending on the time of day. Accordingly, during peak periods, the price increases to reflect higher electricity generation and distribution costs.

Such rates would allow for more efficient use of Québec's electrical resources by encouraging consumers to better spread out consumption during the day to achieve savings. On the other hand, the distributor would generate savings by satisfying more stable demand and reducing peak period demand.

☐ New fields of user fees or taxation

Furthermore, new fields of user fees or taxation could be contemplated.

User fees or generalized taxation of water in the household or institutional sectors should be explored, in particular to reduce waste.

The imposition of tolls on roads and bridges is also a field that Québec should examine to better fund the development or maintenance of infrastructure and reduce congestion. However, the imposition of tolls must abide by certain principles, in particular to ensure a coherent approach and ensure that the attendant revenues are used solely to fund transportation.

❑ Monitor research under way

In Canada, the findings of the future research of Canada's Ecofiscal Commission[64] could prove to be highly useful to Québec, above all for the sake of harmonization or concerted, non-competitive initiatives with the other provinces.

Furthermore, the initiative shows that this type of intervention is becoming increasingly important in public policies.

Water consumption in Québec

Statistical data

In 2006, per capita drinking water consumption in Québec stood at 795 litres per person per day. In Canada, such consumption stood at 591 litres per person per day, i.e. 26% less.

User fees for drinking water services in the municipalities are often set according to a lump sum unrelated to direct consumption. Indeed, in 2004, 66% of Québec municipalities relied on flat-rate pricing for drinking water services compared with 43% for other Canadian municipalities.

In 2006, 17% of customers in Québec had a water meter, compared with 63% in the rest of Canada.

In 2004, water services cost, on average, $21.69 per month in Québec, as against $37.33 per month for Canada overall.

The advantages of water meters

User fees based on actual consumption that requires the installation of water meters would have the advantage of:

- broadening knowledge of the cost of the service;
- increasing user fee revenues to improve the quality of services;
- reducing consumption, which would limit costs.

Sources: Gouvernement du Québec, *Stratégie québécoise d'économie de l'eau potable*, 2011, and Ministère des Finances du Québec.

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[64] For additional information, see the website of Canada's Ecofiscal Commission http://ecofiscal.ca/.

6. COLLECT ALL TAX REVENUES

The sixth objective that the committee has adopted concerns the collection of tax revenues. The tax reform must enable the Québec government to **collect all tax revenues.**

The new information and communications technologies and the globalization of trade have given a new dimension to tax evasion and tax avoidance.

What is more, the advent and development of e-commerce are raising the question of the collection of taxes related to such commerce.

❑ A veritable erosion of the tax base

We are witnessing a genuine erosion of the tax base, which is affecting Québec and all jurisdictions.

The question is a crucial one. The erosion of the tax base compromises funding for public services. Individuals do not accept the injustice of the non-collection of all tax revenues.

To enable Québec to collect all of its tax revenues, the committee is proposing a threefold approach:

- the fight against tax evasion, tax avoidance and aggressive tax planning schemes;
- the collection of sales tax and income tax pertaining to e-commerce;
- better oversight of provisions respecting trusts.

6.1 The fight against tax evasion, tax avoidance and aggressive tax planning schemes

Tax evasion and tax avoidance refer to an array of initiatives that certain taxpayers, both individuals and corporations, undertake to reduce the amount of tax payable.[65]

❑ Tax evasion

Tax evasion indicates the behaviour of an individual or a corporation that deliberately makes false or misleading declarations, fails to comply with a taxing statute or attempts to evade tax or to obtain a refund to which the taxpayer is not entitled.

By engaging in tax evasion, the individual or the corporation violates one or more legislative provisions. Tax evasion is also illegal.

Undeclared work is one source of tax evasion, including moonlighting, concealment by individuals of income, or the concealment of a portion of the sales of corporations.

Tax evasion also includes false or misleading claims for tax benefits submitted by individuals or corporations, i.e. claims for benefits to which the taxpayers are not entitled. The best examples of such claims are applications for the deduction of false expenses and the attendant tax credits.

❑ Tax avoidance

Tax avoidance is a form of planning that does not contravene any specific rule in the statute but does not comply with the intent and spirit of the law.

One example of tax avoidance is an individual who avoids any tax in Québec when he sells a property by means of a series of operations involving legal structures located outside Québec.

To combat tax avoidance, the Québec and federal governments have introduced the so-called "general anti-avoidance rule." As its name indicates, the general anti-avoidance rule targets operations carried out for tax reasons that comply with neither the intent nor the spirit of the law. The avoidance operation must be of an abusive nature.

■ Aggressive tax planning schemes

Certain tax planning schemes border on tax avoidance. To respond to such schemes, Québec has defined the concept of "aggressive tax planning."[66]

Aggressive tax planning schemes reduce tax without its being possible to determine at first sight whether or not the reduction abides by the intent and the spirit of the law. Aggressive tax planning schemes are often complex operations that encompass several stages and rely on sophisticated mechanisms.

For Québec, the fight against tax evasion and the responses to tax avoidance differ considerably depending on whether reference is made to activities directly linked to Québec's territory and subject to Québec statutes, or interprovincial or international activities.

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[65] See Ministère des Finances du Québec, *Un portrait général du régime fiscal au Québec*, information document prepared at the request of the Québec Taxation Review Committee, September 2014, page 65.

[66] Revenu Québec uses the expression "abusive tax planning."

❑ In Québec's territory

In Québec's territory and more generally speaking in the fields under its jurisdiction, the Québec government has assigned to Revenu Québec a mandate to combat tax evasion, tax avoidance and aggressive tax planning schemes.

To this end, the government has granted Revenu Québec significant means and powers to intervene accompanied by demanding objectives respecting the tax revenues to be recovered.

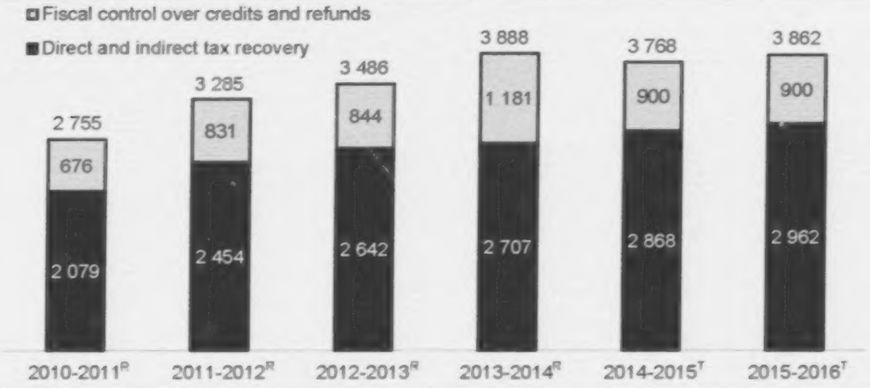
■ The results obtained by Revenu Québec

In recent years, Revenu Québec has stepped up its fight against tax evasion. This intensification increased total tax recovery by 41.1%, i.e. $1.1 billion, between 2010-2011 and 2013-2014. Total tax recovery encompasses all tax recovery operations, including tax audits of credits and refunds.

The government anticipates that Revenu Québec's tax recovery will reach $3 768 million in 2014-2015 and $3 862 million in 2015-2016.

CHART 8

Revenu Québec tax recovery
(millions of dollars)



R: Results.
T: Targets.
Source: Ministère des Finances du Québec, Budget 2014-2015 – Budget Plan, June 2014.

Major, innovative initiatives

Revenu Québec has implemented several major, innovative initiatives that have enabled the Québec government to recover a significant portion of the amounts due.

The fight against tax evasion

Revenu Québec has launched several initiatives to effectively combat tax evasion. In particular, mention should be made of:

- the introduction of sales recording modules in the food service industry;
- Revenu Québec's sustained presence on major public and private construction sites;
- the introduction of the Revenu Québec certificate for public construction contracts;
- the wealth indicators project.

The fight against tax avoidance and aggressive tax planning schemes

Québec has also been very proactive in the realm of tax avoidance with respect to control of aggressive tax planning schemes.

It has implemented compliance assessment tools such as compulsory preventive disclosures, information requests concerning trusts and extensions of the period of limitation under certain circumstances.

Québec was the first jurisdiction in Canada to establish rules aimed at combating aggressive tax planning schemes, which has enabled it to participate in the effort undertaken by tax administrations in the developed countries to promote integrity in the fight against tax avoidance and aggressive tax planning schemes.

The Government of Canada subsequently introduced rules governing the disclosure of avoidance operations.

Québec's efforts have paid off. A number of aggressive tax planning schemes have been identified and some of them have been curtailed.

Despite such efforts, taxpayers continue to resort to aggressive tax planning schemes to avoid tax.

Recommendation 52

Bearing in mind the initiatives already undertaken, the committee recommends that Québec pursue the fight against tax evasion, tax avoidance and aggressive tax planning schemes.

☐ At the interprovincial level

Revenu Québec is focusing, in particular, on the fight against tax avoidance and, more specifically, aggressive tax planning schemes.

A number of interprovincial aggressive tax planning schemes have been identified, of which a significant number have been eliminated.

Despite progress in this respect, taxpayers continue to resort to undesirable tax planning schemes.[67] By way of an example, the debts of a corporate group can be contracted by a corporation in a jurisdiction with a high tax rate. Management fees may also be paid by a corporation for another corporation in the group in a jurisdiction with a lower tax rate.

To counteract such schemes, cooperation between the provinces is essential. It is hard for Québec to act alone. It must, ideally, avoid possible double taxation.

Recommendation 53

The committee recommends that the Québec government step up discussions with the other provinces and the federal government in order to further promote collaboration between the different jurisdictions.

In practical terms, this question should be put on the agenda of interprovincial or federal-provincial meetings, for example within the framework of the finance ministers' conferences or the Council of the Federation.

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[67] See Gilles N. Larin, Lyne Latulippe and Marwah Rizqy,in collaboration with Carmina Chan, *La fiscalité internationale et interprovinciale au Québec*, study produced for the Québec Taxation Review Committee, Research Chair in Taxation and Public Finance, Université de Sherbrooke, November 20, 2014, in Volume 5 of this report.

☐ At the international level

At the international level, the fight against tax evasion, tax avoidance and aggressive tax planning schemes is of a different order.

■ Highly complex questions

Tax evasion and tax avoidance raise major, highly complex challenges.

The jurisdictions commonly called tax havens are characterized by rules that guarantee secrecy to depositors. Such secrecy is usually linked to fraudulent manœuvres in relation to the depositor's country of origin.

Tax havens

A State is deemed to be a tax haven when it satisfies several conditions.

- Taxes are non-existent or very low.
- It has very strict laws to protect banking secrecy.
- The administration of the taxation system lacks transparency.
- There is no genuine collaboration as regards information exchanges with other countries.

In 2000, the OECD published a list of 35 countries deemed to be tax havens.

In order to be withdrawn from the list, the countries had to agree to modify their ways of doing business.

The questions of tax avoidance and aggressive tax planning schemes also arise at the international level with respect to other questions, such as those related to:

- intellectual property;
- hybrid corporations;
- transfer pricing.

■ Considerable financial challenges

These complex questions raise considerable financial challenges.

There is no accurate information on the tax leakage that Québec incurs because of tax evasion, tax avoidance and aggressive tax planning schemes at the international level.

▪ Changes in direct Canadian investments abroad are one indication

However, an examination of changes in direct Canadian investments abroad offers some indication of the scope of the phenomenon.

In 2013, direct Canadian investments abroad were substantial in a number of countries with favourable taxation such as Switzerland ($6.9 billion), Bermuda ($10.7 billion), Ireland ($16.0 billion), Luxembourg ($30.2 billion), the Cayman Islands ($30.9 billion) and Barbados ($63.0 billion).

The investments were incommensurable with the economic activity brought to the countries. In the case of Barbados, Canadian exports to the country stood at $152.0 million in 2013, when the country's GDP reached CAD$4.4 billion. In other words, Canadian investments alone in Barbados were 14.3 times higher than the country's GDP.

By contrast, again in 2013, direct Canadian investments reached $5.7 billion in France, $8.2 billion in Germany, $12.3 billion in Mexico, and $23.4 billion in Australia. To give an order of magnitude, in 2013, direct Canadian investments in Barbados were equivalent to roughly 11 times such investments in France.

▪ Astonishing growth

For the period 2000-2013, growth in direct Canadian investments in certain jurisdictions was astonishing.

It reached 220% in the case of investments in Barbados, up more than $43 billion, 704% for the Cayman Islands, and 1 809% for investments in Luxembourg.

It should be noted that a province-by-province breakdown of the data is not available.

TABLE 9

Direct Canadian investments abroad

(in millions of dollars, percentage change)

	2000	2013	Change between 2000-2013
All countries	356 506	779 292	119%
Certain countries:			
United States	177 943	318 346	79%
United Kingdom	35 170	86 087	145%
Barbados	19 668	62 953	220%
Cayman Islands	3 839	30 879	704%
Luxembourg	1 583	30 224	1 809%
Australia	3 104	23 444	655%
The Netherlands	10 490	17 742	69%
Chile	5 421	16 642	207%
Ireland	7 255	15 976	120%
Mexico	3 857	12 289	219%
Brazil	6 667	11 053	66%
Bermuda	9 482	10 696	13%
Germany	4 572	8 230	80%
Switzerland	3 147	6 913	120%
France	4 642	5 745	24%

Source: Statistics Canada.

■ An international priority

The developed countries have gradually become aware of these challenges such that the fight against tax evasion, tax avoidance and aggressive tax planning schemes is now deemed to be a priority in international discussions and negotiations.

▪ The 2013 OECD action plan

On July 19, 2013, the OCDE published the *Action Plan on Base Erosion and Profit Shifting.*[68]

The plan stresses the need for tax authorities to develop a concerted, innovative approach to combat tax avoidance problems linked to:

- e-commerce;
- transfer pricing;
- aggressive tax planning schemes;
- any other means that allows certain taxpayers to unduly reduce their tax liabilities through planning that involves entities located in several countries.

▪ Growing public awareness

This vigorous international effort coincides with growing public awareness.

In the developed countries, citizens are finding it increasingly difficult to accept the unfairness of the tax burden stemming from tax evasion, tax avoidance and aggressive tax planning schemes.

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[68] OECD, *Action Plan on Base Erosion and Profit Shifting*, July 19, 2013.

Tax planning abroad: several illustrations from the International Monetary Fund

The essential aim of tax planning schemes is to shift taxable income to low-tax jurisdictions. Precisely how this is done is driven by specific features of national tax systems and treaty networks.[1] Below are illustrations of the most common strategies.

Abusive transfer pricing

Abusive transfer pricing (stretching, violating or exploiting weaknesses in the arm's length principle) is often raised as a concern, ranging from potential mispricing of natural resources to the transfer of IP rights to low tax jurisdictions early in their development, when they are hard to value verifiably.

Taking deductions in high-tax countries...

Funds are borrowed there to lend to affiliates in lower-tax jurisdictions.

...as many times as possible

Passing on funds raised by loans through conduit companies (ones, that is, serving solely as intermediaries within a corporate group) may enable double dipping (taking interest deductions twice or more), without offsetting tax on receipts, leading to thin capitalization (high debt ratios).

Risk transfer

Conducting operations in high-tax jurisdictions on a contractual basis, so limiting the profits that arise there.

Exploiting mismatches

Tax arbitrage opportunities can arise if different countries classify the same entity, transaction, or financial instrument differently (the US "check the box rules"[2] being a prime example of a provision with major unintended consequences in this regard).

Treaty shopping

Treaty networks can be exploited to route income so as to reduce taxes.

Locating asset sales in low jurisdictions

This strategy is used to avoid capital gains taxes (a particular concern in the context of recent resource discoveries in some low-tax countries).

Deferral

Companies resident in countries operating worldwide systems can defer home taxation of business income earned abroad by delaying paying it to the parent.

Inversion

Companies may be able to escape repatriation charges of controlled foreign corporation (CFC) rules by changing their residence.

[1] Excellent examples are described in OECD, *Addressing Base Erosion and Profit Shifting*, February 2013, and in Jack Mintz and Alfons Weichenreider, *The Indirect Side of Direct Investment*, Cambridge: MIT Press, 2010.

[2] The US Treasury enacted the rules in 1996 to allow corporations to choose for themselves or for any of their foreign or local subsidiaries and according to certain parameters whether they are taxed as corporations or if they are fiscally transparent (an entity that is ignored). The rules were elaborated for the purposes of simplification and gave rise to sweeping tax planning possibilities, including that of more readily avoiding the rules that apply to controlled foreign corporations.

Source: See *Spillovers in International Corporate Taxation*, International Monetary Fund, May 9, 2014, page 11.

Responses

In point of fact, the fight against tax evasion, tax avoidance and aggressive tax planning schemes at the international level is mainly waged by federal tax authorities, who rely on Canadian legislation, including the international treaties negotiated by the Government of Canada. Canada has signed 92 tax treaties with other countries. However, it must be emphasized that the tax treaties signed by the federal government are not binding on the provinces. Québec recognizes the tax treaties signed by the federal government with other countries.

The Canada Revenue Agency elaborates its audit strategy according to its own criteria.

Québec is poorly equipped to singlehandedly fight tax evasion, tax avoidance and aggressive tax planning schemes at the international level.

At present, the role of Québec taxation authorities consists, above all, in sharing their know-how with the federal tax administration and in collaborating with it through the transmission of data pertaining to its own fields of jurisdiction.

Facilitate information exchanges

The first way to fight against tax evasion, tax avoidance and aggressive tax planning schemes at the international level is to facilitate information exchanges between tax administrations.

"Tax information exchange agreements" are intended to support international cooperation in tax matters by encouraging information exchanges. It is essential for Revenu Québec to benefit regularly from such information.

There exists an agreement on exchanges of information on taxes and other duties that calls for the exchange of certain information at a set frequency. Such an exchange exists between the Canada Revenue Agency and Revenu Québec concerning certain forms.

As an example, the Canada Revenue Agency may send to Revenu Québec information on the information return for transactions with non-residents operating with an arm's length relationship.

- **International action in respect of transfer pricing**

A second tool to combat tax evasion, tax avoidance and aggressive tax planning schemes is international action in respect of transfer pricing.

In 2013, the OECD member countries agreed to define a common plan concerning transfer pricing.

The project seeks to ensure that profits are taxed where the economic activities that generate profits are carried out.

Transfer pricing rules in Québec hinge on the arm's length principle. Québec has harmonized the rules concerning transfer pricing with those of the federal government.

However, it is obvious that Québec's tax base is affected by the transfer of profits in jurisdictions with more advantageous taxation. To ensure compliance assessment, it would be desirable for Revenu Québec to have access to other information through the Canada Revenue Agency.[69] Close collaboration with the federal government should thus be established regarding information exchanges.

Recommendation 54

The committee believes that the Québec government must clearly indicate its concern about the fight against tax evasion, tax avoidance and aggressive tax planning schemes.

Québec should vigorously support international efforts to fight against tax evasion, tax avoidance and aggressive tax planning schemes.

The committee recommends that Québec establish a centre of expertise devoted to the fight against tax evasion, tax avoidance and aggressive tax planning schemes. Such an initiative is one means of playing a leading role in the fight.

The committee also recommends that the federal government be asked to inform the provinces and the public of the extent of the problem and the solutions that it is implementing or intends to implement.

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[69] See Gilles N. Larin, Lyne Latulippe and Marwah Rizqy, in collaboration with Carmina Chan, *La fiscalité internationale et interprovinciale au Québec*, study produced for the Québec Taxation Review Committee, Research Chair in Taxation and Public Finance, Université de Sherbrooke, November 20, 2014, in Volume 5 of this report.

❑ Tax audits

The question of tax evasion and tax avoidance led the committee to broach the problem of tax audits.

The committee has observed that Revenu Québec's initiatives raise questions and criticism from the taxpayers concerned.

It was made aware of the difficulties during the public consultations.

Moreover, in its 2013-2014 annual report, the Québec Ombudsman expressed concern, in particular, about:

- Revenu Québec's refusal to consider individuals' explanations;
- the hasty issuing of proposed assessments;
- a restrictive interpretation of the legislation;
- a rigid attitude.

Faced with these questions and criticisms, the committee nonetheless wishes to point out the importance of according Revenu Québec all of the means necessary to fight against tax evasion, tax avoidance and aggressive tax planning schemes.

Recommendation 55

The committee recommends that simple initiatives be implemented to ensure better follow-up to the processing of taxpayers' files during an audit.

- The committee is referring, in particular, to the numbering of proposed assessments, which would make it possible to more readily track the advancement of taxpayers' files.
- The committee also recommends that the government evaluate the establishment of a dispute settlement mechanism.
- Furthermore, customer service should be evaluated after each audit.
- Lastly, Revenu Québec should maintain public statistics concerning the proportion of new assessment notices that are maintained following an appeal or litigation.

6.2 The collection of sales tax and income tax pertaining to e-commerce

The generalization of the Internet has spawned a veritable revolution in trade relations with the introduction and development of e-commerce.

From a fiscal standpoint, the development of e-commerce has engendered major problems as regards the collection of sales tax and income tax.

Taxation authorities are having considerable difficulty applying taxation rules to electronic trade transactions when such transactions are performed by a supplier outside the territory that the authorities control. The new technologies now make it possible to do business in Québec and maintain a strong economic presence there without owning a stable establishment or operating businesses and, therefore, without be subject to income tax.

This problem is not specific to Québec and affects all jurisdictions.

☐ Collection of the sales tax

The problem of the collection of sales tax is now well known.

■ An estimate of tax losses

In the case of Québec, Revenu Québec estimated in 2012 at $165 million the tax losses sustained by the Québec government because of online purchases made by Quebecers from suppliers established outside Canada.

It is difficult to estimate the losses stemming from online purchases that Quebecers make from suppliers in other provinces but the amount is undoubtedly significant. Revenu Québec has advanced a figure of $300 million.

Such estimates must be considered cautiously since little data is available on e-commerce.

■ The very rapid growth of e-commerce

These figures certainly give an idea of the scope of the problem, if only because of the extremely rapid growth of e-commerce.

According to the Canadian Internet Use Survey conducted in 2012 by Statistics Canada,[70] 53.5% of Quebecers 16 years of age or over had ordered goods or services online, compared with 55.7% of Canadians, a 7.3-percentage-point increase in relation to the previous survey conducted in 2010.

The same survey indicates that 78.1% of Quebecers had ordered goods or services online from at least one Canadian supplier, 53.4% from at least one American supplier, and 24.6% from at least one supplier from another country.

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[70] Statistics Canada, *Canadian Internet Use Survey* – Household access to the Internet and individual online behaviours including electronic commerce, October 28, 2013.

We urgently need to act

The committee wishes to emphasize that the tax losses that the Québec government has already sustained are considerable and can only increase in the future if the problem of collecting sales tax on e-commerce transactions is not resolved.

We therefore urgently need to act, but the initiatives to be taken are not easy to define and implement.

No specific rules now govern e-commerce

In Québec as in the rest of Canada, there are no specific rules concerning e-commerce in current legislation governing the Québec sales tax (QST), the federal goods and services tax and the harmonized sales tax (GST/HST).

E-commerce transactions are thus subject to the general QST and GST/HST rules and to existing taxing statutes.

- Canadian suppliers that sell taxable goods and services online in Canada are usually obliged to register with the GST/HST registry for the purposes of collecting taxes on such sales and the payment of the taxes to the tax authorities.
- The suppliers are also usually obliged to register with the QST registry for the collection and payment of the tax to the taxation authorities if they maintain a physical presence in Québec (the notion of a stable establishment) or a significant presence (the notion of the operation of a business).
- Foreign suppliers that maintain a physical or significant presence in Canada and, as the case may be, in Québec, have the same obligations.

The source of the difficulties

The problem stems from the impossibility for Québec and for Canada to force suppliers to register when they are located outside their control area and they maintain neither a physical nor a significant presence in the territory.

The tax rules stipulate that, in this instance, the purchaser must pay by self-assessment the taxes payable in respect of the goods and services acquired online from the suppliers except in the case of tangible personal property imported into Canada.

In point of fact, the obligation concerning self-assessment is not observed, probably partly through ignorance. It is practically impossible for the tax authorities to control its application. Revenu Québec recorded only six self-assessment declarations in 2011 and five in 2012.

Transactions conducted by suppliers from foreign countries

For Québec, problems regarding the collection of QST concern both the transactions conducted by suppliers from the rest of Canada and transactions involving suppliers from foreign countries.

In the case of online transactions conducted by suppliers from foreign countries, a distinction must be made between tangible personal property, intangible personal property and services.

Québec has concluded a QST tax collection agreement with the Canada Border Services Agency with respect to non-commercial transactions concerning tangible personal property imported into Québec. The QST is collected in customs offices in Québec's territory or anywhere else when the property is brought in or received by mail or messenger service.

Québec has no means of collecting the QST on sales of intangible personal property and services effected online by foreign suppliers with no physical or significant presence in its territory.

This problem also affects Canada and all jurisdictions that levy a tax on trade transactions.

Transactions conducted by suppliers located in the rest of Canada

In the case of online transactions conducted by Canadian suppliers that maintain neither a physical nor a significant presence in Québec, the situation is even more difficult because Québec has no means to collect the QST on intangible personal property, services and tangible personal property.

Indeed, since there is no border between the provinces, Québec cannot rely on customs or mail or messenger services to collect the QST on tangible personal property transactions.

The case of the provinces that apply the HST

In the five Canadian provinces that apply the HST[71] under an agreement concluded with the federal government, the provincial portion of the HST applicable to online trade transactions in the provinces is collected by all Canadian suppliers even if the supplier is not present in the territory of the provinces, given that it is registered with the federal GST/HST registry. The tax is paid to the federal government as are the proceeds from the HST.

Accordingly, an Alberta company that does not maintain an office in Ontario must nonetheless collect the HST if it sells online a product destined for Ontario. On the other hand, if it sells online a product destined for Québec and does not maintain an office in Québec, it will collect only the GST at 5%.

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[71] Prince Edward Island, New Brunswick, Nova Scotia, Ontario and Newfoundland and Labrador have concluded with the federal government an agreement to apply the harmonized sales tax (HST) to trade transactions.

An observation: there is no simple solution

The problem raised by the application of existing tax rules governing e-commerce is significant and complex and the committee has observed that there is no simple solution.

Transactions conducted by suppliers located in the rest of Canada

As for online transactions carried out by suppliers located in the rest of Canada, it should be possible to partly remedy the current situation if the federal government agrees to collaborate with the Québec government for this purpose.

It should be noted that QST is better collected on tangible personal property coming from outside Canada than on goods coming from the rest of Canada, because of the collection agreement with the Canada Border Services Agency.

To settle the problem of the collection of the QST on online sales conducted in Québec by Canadian suppliers that do not maintain a physical or significant presence, it is essential:

- that the rules under the QST system be amended, with the agreement of the federal government, to compel all Canadian suppliers that make supplies to Québec without maintaining there a physical or significant presence to register for the application of the system (the federal government's agreement is necessary pursuant to the harmonization agreement concluded in 2012);
- to conclude an agreement with the federal government whereby it agrees to administer the specific registration rules stipulated in the QST system on behalf of Québec.

Recommendation 56

With regard to e-commerce, the committee recommends that the Québec government initiate discussions to obtain the federal government's consent to administer, on behalf of the Québec government, the registrations that would become compulsory under the QST regime for businesses located outside Québec that make supplies to Québec without maintaining there a physical or significant presence.

- **Transactions conducted by suppliers from foreign countries**

In the case of online transactions carried out by suppliers from foreign countries, the problem of the collection of sales taxes is on the agenda in the OECD's deliberations. The fiscal challenges linked to the digital economy are at the forefront of ongoing discussions between the main developed countries.[72]

The key possible solutions on which the OECD's policy group on the digital economy is focusing both in respect of consumption taxes and income tax are to:

— modify the definition of a permanent establishment such that it covers preparatory and ancillary activities that make up the core business of the supplier of online products;

— create a presumption of permanent establishment for digital activities that are fully dematerialized on the basis of a significant digital presence;

— replace the notion of a permanent establishment by a significant presence test when the digital economy hinges partly on a physical presence;

— eliminate the tax exemption for low-value movable chattels acquired online and oblige the foreign suppliers to register with the taxation regime of the importing country and collect and remit there the applicable tax;

— oblige online suppliers of digital services and intangibles to register with the taxation regime of the country of residence of the purchaser and remit the applicable tax.

Recommendation 57

In the case of the collection of sales taxes on online transactions conducted by suppliers from foreign countries, the committee recommends that the Québec government pressure the federal government to step up its efforts within the framework of the OECD's ongoing deliberations.

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[72] OECD, *Action Plan on Base Erosion and Profit Shifting*, July 19, 2013.

E-commerce and taxation: an example of the current situation concerning cultural products

The suppliers of digital cultural products located in Québec may be at a disadvantage in relation to those located outside the province.

Indeed, suppliers located outside Québec are obliged to collect the QST and the GST.

Their competitors are not obliged to collect the QST when they are located elsewhere in Canada and are not obliged to collect the QST and the GST when they are located outside Canada.

For a product advertised at a given price, for example a piece of music for $0.99 or a monthly subscription to a movie streaming website for $8.99, the amount paid by a Québec consumer may be as much as 15% higher when the supplier is present in Québec's territory.

Comparison of the cost of digital cultural products sold in Québec according to the supplier's location
($)

		Amount paid by the Québec consumer depending on the supplier's location[1]		
	Advertised price	**Delaware**	**Alberta**	**Québec**
Piece of music	0.99	0.99	1.04	1.15
Monthly subscription – Movie streaming website	8.99	8.99	9.44	10.34

(1) The difference between the price paid to the supplier located in Delaware and that located in Québec corresponds to the QST and the GST that are not collected, while the difference between the price paid to the supplier located in Alberta and that located in Québec corresponds to the QST that is not collected.

A federal government consultation on the international tax planning of multinational companies

In its 2014 budget, the Government of Canada announced a consultation process on the international tax planning conducted by multinational companies.

Among the questions proposed, the government invited the interveners to make known their opinions on the measures the government should adopt to ensure the effective collection of sales taxes on online sales to Canadians concluded by vendors located abroad.

More specifically, the government asked whether it should proceed as other countries have done and demand that vendors located abroad register and collect the local tax. The consultations ran from February 11 to June 11, 2014.

According to the study commissioned by the committee entitled *L'expérience internationale et les tendances actuelles en matière d'impôts sur la consommation*:

> certain respondents appear to support this approach in particular as regards sales conducted by non-residents to non-registered buyers bearing in mind that this would put foreign and Canadian operators on an equal footing while non-residents now benefit from a competitive advantage insofar as non-registered buyers very rarely self-assess the GST/HST on their purchases.[1]

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[1] Alain Charlet and Stéphane Buydens, *L'expérience internationale et les tendances actuelles en matière d'impôts sur la consommation*, 2014, in Volume 5 of this report.

- **The feasibility of other initiatives**

The committee wonders about the feasibility of other initiatives such as:

— imposing responsibility for collecting and remitting sales taxes on financial payment institutions through which all digital transactions are conducted;

— encouraging foreign businesses to levy the sales taxes on goods and services sold in Canada and in Québec to maintain their image as corporate citizens (voluntary mandataries) by facilitating their task from an administrative standpoint;

— signing a number of cross-border agreements with other jurisdictions to share information.

Recommendation 58

The committee is of the opinion that the Québec government should assume leadership among the Canadian provinces overall with respect to the collection of the sales tax linked to e-commerce conducted with the rest of Canada and foreign countries.

Québec's specific status through the existence of fiscal coordination of the GST and the QST naturally suggests that Québec assume such leadership.

❑ The collection of corporate income tax

In the case of the collection of corporate income tax, the problem is directly tied to the notion of a permanent establishment and the problem exists at the interprovincial and international levels.

As we just noted, the OECD is proposing several possible solutions in order, in particular, to modify the definition of a permanent establishment by adding to it a significant digital presence.

Recommendation 59

The committee recommends that the Québec government pressure the federal government to step up its efforts within the framework of the OECD's ongoing deliberations with respect to the collection of corporate income tax linked to e-commerce and the collection of sales taxes on transactions carried out with foreign countries by means of e-commerce.

6.3 Better oversight of provisions respecting trusts

A trust is an entity that has the capacity to hold property rights on all tangible and intangible property for the benefit of one or more persons called the beneficiaries.

The *Civil Code of Québec* defines a trust as an autonomous special-purpose fund that is separate from that of the settlor, the trustees and the beneficiaries. The trust is a concept that stems from English law, introduced into the *Civil Code.*

It offers several advantages from a legal standpoint, which explains its popularity. A trust allows flexibility in wealth management, the possibility of protecting assets against financial setbacks, and control over remittances to the beneficiaries.

☐ The impact of trusts on the taxation system

From a fiscal standpoint, a trust is deemed to be an individual: the rules governing individuals' liability to Québec tax apply to trusts.

Almost without exception, the trust may deduct from its taxable income the portion of the income paid or payable to a beneficiary during the year. It is the beneficiary who is taxed on the income, unless the trustee decides that the trust is taxed instead.

The federal government adopted the "21-year rule" to periodically tax the capital gain of trusts. Under the rule, the capital gain accumulated without being realized is taxed at least every 21 years.

Québec adopted a similar provision to harmonize its regime with the federal regime.

By virtue of its very flexibility, the concept of a trust allows in certain situations to limit the taxation in Québec of certain income and is, notably, used to this end. In Québec as in Canada, the governments have thus had to define provisions aimed at preventing certain strategies designed for this purpose.

The committee has been made aware of several impacts of trusts on the Québec taxation system and has focused, in particular, on three of them:

- the shifting outside Québec of the tax base;
- the circumvention of the concept of associated companies;
- the splitting of income from corporations.

❑ The shifting outside Québec of the tax base

The first question leads us to wonder about the residency of the trust.

According to the courts, the residency is located in the jurisdiction where the management and control centre of the trust is located. In practice, it may be easy to ensure that the trust resides in a low-tax-rate jurisdiction.

Locating the residency of a trust outside Québec is thus one means used to shift the taxation of income outside Québec to jurisdictions that apply lower tax rates.

Examples of the use of trusts to shift the tax base outside Québec

Below are two examples of the use of trusts that shift certain income outside Québec.

A first example

Tax planning uses a trust residing in Canada to promote shifting income from a business operated in Québec. In principle, the income from a business in Québec should be taxed in Québec regardless of the residency of an individual or the trust earning the income.

The planning scheme ensures that the business income earned by the trust is payable to the beneficiary of the trust and will be taxed in the beneficiary's hands as income from a property that is an interest in the trust. Business income is thus transformed into property income in the hands of the beneficiary. It is taxable in the province of residence of the individual who is the beneficiary of the trust operating the business.

A second example

A tax planning scheme uses a trust residing in Canada in a province with a lower tax rate to acquire a commercial building located in Québec in order to earn rental income from it. Given the structure and services offered by the building's owner, the income from such property may be qualified as property income.

Under the agreement concluded between the provinces on the income distribution of individuals, including trusts, for the purposes of taxation, the property income earned by an individual, including a trust, and the taxable capital gain that he may realize when the property is disposed of are taxable in the province of residence of the individual, or the trust, at the end of the taxation year, regardless of where the property is located.

■ Several worrisome situations

Several situations remain worrisome and are engendering a loss of tax revenues for Québec.

Such is the case with tax planning schemes that limit the taxation in Québec of certain income such as income from businesses operated in Québec or rental income from commercial buildings located in Québec.

Tax planning schemes also limit the taxation of capital gains stemming from the disposition of such buildings.

In recent years, the Québec government has adopted tools to obtain a more complete picture of trusts that engage in activities or possess rental buildings in Québec and ensure that they abide by taxing statutes.

Recommendation 60

To put an end to the worrisome situations that stem from the use of trusts to shift the tax outside Québec, the committee recommends that the Québec government initiate discussions with the federal government and the provinces:

- to agree to amend the tax provision stipulating that the income payable by a trust to its beneficiaries be deemed, almost without exception, to be income from property;
- so that property income from the rental of certain buildings and the capital gains from their disposition be subject to income tax according to the location of the buildings rather than the residency of the trust.

Should the discussions with the federal government and the provinces fail to produce the desired results, the committee recommends that the Québec government contemplate the possibility of acting unilaterally in order to make liable for tax income from a business operated in Québec and rental income from a building located in Québec. Québec could grant a tax credit to offset the tax collected by another province.

More specifically, the existing rules would be amended as follows:

- The Québec taxation system applicable to trusts falls under the Canadian taxation system and the federal government and the provinces should agree to amend the provision stipulating that the income payable by a trust to its beneficiaries is deemed, with some exceptions, to be income from a property.[73]
- The income payable by the trust to its beneficiaries would thus preserve the same nature in the hands of its beneficiaries, with the corresponding tax rules.

It would be desirable for the federal government and the provinces to agree on the coordinated amendment of the income distribution rules in the case of certain trusts so that their property income from the rental of certain buildings located in a province and their taxable capital gains from the disposition of such buildings are liable for income tax according to the location of such buildings and not according to the residency of the trusts.

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[73] Presumption of section 651.1 and paragraph 108 (5) of the *Income Tax Act*.

☐ The circumvention of the concept of associated companies

Under the Québec taxation system, certain rules are based on the concepts of "non-arm's-length relationships," "associated companies" and "related persons."

The concepts can be circumvented by using trusts created within a corporate group, which can mean that the assistance granted to certain entities in a corporate group exceeds what is desirable.

Recommendation 61

As for the use of trusts to circumvent the concept of associated companies, the Québec government has already adopted, under certain circumstances, provisions that stipulate that the trust is deemed to be a corporation for the application of the association rules and the beneficiaries of the trust are deemed to be shareholders of the corporation.

The committee recommends that similar provisions be adopted to interpret the concepts of "non-arm's-length relationships," "associated companies" and "related persons" when a trust is used within a corporate group.

The concept of associated companies

While the concept of associated companies is complex, it can be defined briefly.

Two companies are said to be associated companies when:

- one company directly or indirectly controls the other company;
- the same person or the same group of persons directly or indirectly controls the two companies;
- the person who directly or indirectly controls one of the companies is related to the persons who directly or indirectly control the other company and one of the persons holds at least 25% of the shares issued of a class (not excluded) of the share capital of each company;
- the person who directly or indirectly controls one of the companies is related to each member of the group of persons that directly or indirectly controls the other company and this person holds at least 25% of the shares issued in a class (not excluded) of the share capital of the other company;
- each member of the related group that directly or indirectly controls one of the two companies is related to all of the members of the related group that directly or indirectly controls the other company and one or several persons who are members of the related groups hold alone or together at least 25% of the shares issued in a class (not excluded) of the share capital of each company.

Other legislative provisions allow for certain companies to be related among themselves.

Several tax consequences stem from the fact that companies are deemed to be associated. In particular, they must share the small business deduction and the limit on allowable expenses for the purposes of the scientific research and experimental development tax credit.

☐ The splitting of income from corporations

Income splitting consists in sharing income among the members of the same family in order to take advantage of progressive tax rates and thereby reduce the amount of tax payable.

■ The use of trusts

We have noted that trusts are frequently established in order to take advantage of such splitting, which would normally be more difficult if the trusts did not exist.

For example, ownership by children under 18 years of age of the shares of a company raises questions concerning the rights that such children may exercise by owning the shares directly in their own name. What is more, it may not be desirable for children of legal age and the spouse of the shareholder to directly own shares in the company.

The creation of a trust to own shares in a company may therefore allow greater flexibility by transferring to the trustees the exercising of certain rights related to share ownership. It is in this context that minor children and children over the age of majority and the spouse are often named as beneficiaries.

This form of ownership allows for the distribution by the trustees to the beneficiaries of the trust of income such as a dividend or a capital gain.

This form of tax planning has for many years become increasingly widespread in Québec. Since 2001, a number of professionals have been able to engage in their activities through a company. When they incorporate, numerous professionals set up a trust that owns the shares of the company, which enables them to share the income with members of their family.

■ Current legislation

At present, federal and Québec taxing statutes make provision for a special tax on split income for taxpayers under 18 years of age to prevent certain forms of splitting.

The tax on split income is also called the "kiddie tax." It applies, in particular, to dividends received from private corporations and to capital gains on the disposition of the shares of a private corporation in favour of a person dealing on a non-arm's length basis.

When the rules apply, the kiddie tax is calculated at the highest marginal rate of the personal income tax rate schedule.

Recommendation 62

The committee recommends that the government initiate discussions with the federal government to amend the rules in force concerning income-splitting and, more specifically, the concept of split income.

The committee is proposing to extend the tax on split income for minor children to children of legal age and the spouse, with the exception of those among them who participate in the company's activities.

Making such taxpayers liable for the tax on split income would significantly reduce certain types of planning schemes that rely on income-splitting.

■ Income-splitting and the lifetime capital gains exemption

Income-splitting, especially by means of trusts, raises the possibility of adopting tax planning schemes that allow the beneficiaries to take advantage of the lifetime capital gains exemption.

According to tax statistics, for the 2009, 2010 and 2011 fiscal years, the lifetime capital gains exemption claimed by taxpayers under 20 years of age stood on average at $90 774, compared with $53 556 for applicants overall.[74]

We examined earlier the rules governing the lifetime capital gains exemption.[75]

When a corporation qualifies as a corporation operating a small business, the sale of the shares of the latter by a trust may make it possible to multiply the lifetime capital gains exemption. Indeed, if the capital gains from the trust or a portion thereof are attributed by the trustees to the beneficiaries, the latter may take advantage of the capital gains exemption provided that certain conditions are met.

Such income-splitting could be possible with the spouse, the minor children and the children of legal age of the shareholder of the corporation.

Recommendation 63

The committee recommends that the government initiate discussions with the federal government to limit certain planning schemes concerning the lifetime capital gains exemption.

Accordingly, the committee is proposing that a minor child no longer be allowed to benefit from the lifetime capital gains exemption when shares are transferred to a person with whom the minor child has no arm's length relationship in order to limit the attendant tax planning schemes.

Moreover, the lifetime capital gains exemption should only be available to children of legal age and the spouse who participate in the activities of a family business.

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[74] See Table 3 of the documents *Statistiques fiscales des particuliers – Année d'imposition 2009, Statistiques fiscales des particuliers – Année d'imposition 2010* et *Statistiques fiscales des particuliers – Année d'imposition 2011* of the Ministère des Finances du Québec.

[75] See page 117.

❑ The importance of information returns

To conclude, it bears noting that for several years Québec tax legislation has obliged trusts to produce an information return on specific situations when the trusts do not have to file a tax return, which enables Revenu Québec to obtain a more complete picture of trusts.

This obligation is a key factor for the implementation of the committee's recommendations concerning income-splitting.

Socio-fiscal credits: should we compel the recognition of assets?

The considerable number of socio-fiscal tax credits and their generosity may encourage taxpayers to engage in tax planning schemes in order to be entitled to them. Indeed, since certain measures are reducible according to income, planning schemes aimed at transferring to other entities certain income enables taxpayers to gain access to the measures even if they own significant assets.

The committee has analyzed the possibility of adding the recognition of the value of a taxpayer's assets when the amounts of socio-fiscal tax credits are calculated.

The committee recommends that the proposal not be implemented because of the difficulties that such a measure would engender. Furthermore, there is little data available on the phenomenon and it is hard to ascertain the impact of such a measure.

7. ADAPT TAXATION TO A CHANGING SOCIETY

The seventh objective that the committee has adopted refers to the numerous, rapid changes occurring in Québec society, to which it must adapt.

The demographic changes now under way are directly affecting economic growth because of their impact on the size of the labour force.

The same demographic changes have also affected demand for public services. Québec must reform its tax system in order to adapt its methods of funding public services to such changes.

The seventh objective that the committee has adopted, **adapt taxation to a changing society**, means that we must reform the tax system to adapt how we fund public services to such changes that we are experiencing collectively and thus ensure the long-term survival of such funding.

The committee has identified two major changes that concern taxation:

— setting fees for reduced-contribution childcare services;

— the sound management of tax expenditures.

User fees for services: sectors excluded from the committee's analysis

The committee has excluded from its analysis setting user fees for health services and for higher education for the reasons indicated at the beginning of the report.

User fees for health services

The question of setting user fees for health services utilization is extremely complex and raises questions that lie outside the field of fiscal analyses. The issues at stake are related to intergovernmental relations and exceed the mandate assigned by the government.

User fees for higher education

The committee has also decided not to analyze the question of setting fees for higher education, although the question has been subject to extensive debate in recent years. The government has defined guidelines and the committee felt that it was not useful to reopen the topic.

7.1 User fees for reduced-contribution childcare services

The committee received from the government a mandate to assess the possibility of subjecting to taxation certain user fees in order to take into account the ability to pay of the users of public services, bearing in mind the impacts on the implicit marginal taxation rates.

Setting user fees for childcare services falls within the scope of the mandate.

❑ A recommendation that precedes the announcement of the changes adopted by the government

The committee established its recommendation concerning user fees for reduced-contribution childcare services before the government announced changes in this respect in November 2014.[76]

The changes that the government adopted differ from the committee's recommendation. However, the committee wishes to maintain its recommendation.

It believes that the fee-setting method that the government announced in November 2014 and that is to apply in the short term could mark the first step toward the method that it is proposing.

Recommendation 64

The committee recommends a revision of the method of funding reduced-contribution childcare services through the taxation of a single rate. The revision is intended, above all, to ensure the long-term survival of the reduced-contribution childcare services network.

The committee has thus ensured in the definition of its proposal that it is not raising the cost of childcare services for most families in relation to funding at $7.30 a day and, indeed, that it is reducing it for low- or middle-income households.

In its scenario, the committee is proposing to:

- set the gross rate, before tax compensation, at $35 per day;
- make the rate eligible for the Québec refundable tax credit for childcare expenses, which would be enhanced;
- subsequently index the rate annually.

The advance payment of the tax credit for childcare expenses should, what is more, be adapted to ensure that all families affected by the change may take advantage of it as soon as it comes into force.

The committee also recommends the application to school childcare services of a revision concerning the principle of fiscalization but adapted to the specific nature of such services.

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[76] The committee's advisory opinion was submitted to the Minister of Finance at his request on November 18, 2014 (see Volume 4 of this report for the unabridged version of the opinion).

☐ The real cost that families bear

The proposed gross fee of $35 per day would not be the real cost that families bear since they would benefit from Québec and federal government assistance.

- The rate of the Québec tax credit for childcare expenses would be raised from 75% to 80% for low-income families and maintained at that level up to family income of $54 625.
- The fee would entitle the taxpayer to the maximum amount of the federal government's deduction for childcare expenses.

The subsidy paid for spaces in reduced-contribution childcare services would, by way of compensation, be reduced in order to maintain the current level of funding for a space.

☐ Savings for the government and for families

With the proposed changes, the government would generate additional savings of $101 million starting in the year the new rate formula is implemented, in relation to the funding methods that the government announced in November 2014.

Despite the additional savings, the cost that families bear would be lower. The funding method that the committee is recommending would, indeed, recover a more substantial portion of the costs through federal taxation, in relation to the formula that the government adopted.

☐ Recognize the limited cash resources of certain families

However, the implementation of this scenario requires recognition of the impact for families of having to finance at the outset the higher gross rate, which can pose a problem of cash resources for a number of them.

The committee has noted that families whose children attend reduced-contribution childcare services are already experiencing this situation.

Québec has established an advance payment system for the tax credit for childcare expenses, on a monthly basis. The system should be adapted to satisfy a growing number of beneficiaries of the tax credit to ensure that all families affected by the change may take advantage of it as soon as it comes into force.

The changes announced in the user fees for reduced-contribution childcare services

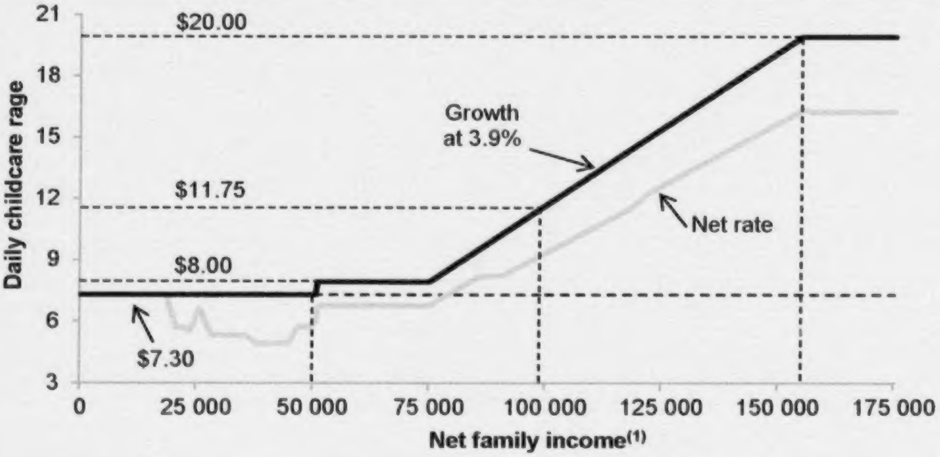
On November 20, 2014, the government announced the establishment of additional user fees for reduced-contribution childcare services depending on the parents' income. The user fees, which are payable when income tax returns are filed, are added to the $7.30 per day paid to the childcare service.

As of April 1, 2015, the new daily rate will be:

- $7.30, on income up to $50 000;
- $8, on income up to $75 000;
- $20, on income of $155 000.

The amounts paid under the additional fees will be eligible for the federal childcare expense deduction.

An illustration of the childcare rate for a couple with one child and two equal incomes – 2015
($)



(1) Family income corresponds to total household income less certain deductions such as the contributions to a registered retirement savings plan or a registered pension plan.

❑ School childcare services

The committee has also examined the question of school childcare services.

The revision of the funding formula that the committee is proposing with respect to reduced-contribution childcare services cannot be applied directly to school childcare services.

However, the committee also recommends the application to school childcare services of a revision concerning the principle of taxation but adapted to the specific nature of such services.

- The full rate of $12.73 would be demanded of parents.
- A new tax credit modeled on the proposed tax credit for preschool childcare services would be granted in respect of such fees in order to reduce their cost.

The parameters of the new tax credit would, however, be adjusted so that the parental contribution is adjusted according to income, but at zero cost to the government and families overall.

■ The protection of low- or middle-income families

As is the case under the scenario for reduced-contribution childcare services, families whose family income falls below roughly $110 000 would not pay more than under the $7.30 per day rate and many of them would pay a lower net cost. For families with incomes of more than $110 000, the net cost would increase according to income.

Accordingly, low- or middle-income families would benefit from a lower net cost while the cost would only increase for those with higher incomes.

7.2 The sound management of tax expenditures

The committee's proposed reform consists in reducing personal income tax, corporate income tax and the payroll tax for the benefit of all taxpayers and in partially funding the reduction through a reduction of tax expenditures.

Accordingly, the committee conducted a systematic analysis of existing tax expenditures pertaining to individuals and to corporations.

☐ Better manage tax expenditures in the future

Once the analysis has been completed and the recommended tightening measures have been carried out, it is essential to ensure for the future sound management of tax expenditures that illustrates the adaptation of Québec taxation system to changes in society. The committee is of the opinion that it is essential to better manage tax expenditures and, in particular, to:

- avoid in the future a new multiplication of such measures;
- put an end to measures for which there no longer any rationale;
- ensure better transparency in the tax expenditures adopted;
- respond to the tax competition that is developing between jurisdictions.

☐ An arbitration mechanism

Recommendation 65

The government has indicated its determination to apply an arbitration mechanism also called the "safety catch" to budgetary expenditure. The committee recommends that the same logic be applied to tax expenditures.

This stringent control would ensure that new tax expenditures cannot be implemented unless tax expenditures of an equivalent scope are simultaneously eliminated.

The 1992 federal *Spending Control Act*[77] can serve as an example. The legislation set ceilings on public expenditures for the 1991-1992 to 1995-1996 fiscal years. However, its scope was confined to budgetary expenditure without regard to tax expenditures. During the period covered, the federal government introduced significant new initiatives through tax expenditures.

The committee is of the opinion that in the absence of measures that explicitly target tax expenditures, the desire to apply budgetary constraints may push governments to adopt tax expenditures as a substitute.

The government should, accordingly, justify the choice of resorting to tax expenditures. It should be noted that certain refundable tax credits are similar to subsidies.

☐ A necessary periodic evaluation

Recommendation 66

The committee recommends that tax expenditures be subject to periodic evaluation.

The periodic evaluation framework would apply to all tax expenditures.

The framework adopted would specify the prescribed time limit within which a re-evaluation must be conducted, e.g. within five years.

Each tax expenditure with a specific scope should have a termination date. It would also be necessary to indicate the type of re-evaluation to be conducted and the indicators to be used.

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[77] *Spending Control Act* (S.C. 1992, c. 19).

❑ Integrate accountability concerning tax expenditures into the budget documents

Recommendation 67

The committee recommends that accountability respecting tax expenditures be integrated into the budget documents tabled in the National Assembly.

Each year, the Ministère des Finances produces a publication devoted to tax expenditures that is rarely tabled at the same time as the budget documentation.

To enhance the understanding of parliamentarians, the report on tax expenditures should be tabled in the National Assembly.

❑ Enhance the transparency of tax expenditures

At present, the beneficiaries of corporate tax credits are not disclosed although certain refundable tax credits are similar to subsidies.

For the sake of transparency, it is advisable to make public the name of corporations that benefit from refundable tax credits, as is the case for businesses that receive subsidies.

Recommendation 68

To enhance budget transparency, the committee recommends that the list of corporations that obtain refundable tax credits, beyond a certain threshold, be published, as well as the amounts in question.

❑ Limit tax competition

States engage in tax competition in different ways. The main objective of tax competition is to attract the assets, activities and remuneration associated with risk-taking in a given territory because each of the elements is a source of added value.

However, when jurisdictions attempt to outdo each other, all of the jurisdictions experience lower tax revenues, which consequently curtails their ability to fund public services and transfers.

Once this situation arises, any reduction in the advantages accorded raises the risk, whether or not it is real, that the corporations will shutter their operations or delocalize, with the attendant job losses.

If the tax assistance ultimately serves only to attract businesses without allowing for the development of a genuine competitive edge and enhanced productivity, all of the jurisdictions participating in this tax competition are jointly wasting their public funds.

For Québec, such tax competition comes into play both at the international and interprovincial levels.

Recommendation 69

The committee recommends that the question of interprovincial tax competition be put on the agenda of interprovincial or federal-provincial meetings, for example within the framework of the finance ministers' conferences or the Council of the Federation.

8. ENSURE THE EQUITABLE REDISTRIBUTION OF COLLECTIVE WEALTH AND ADEQUATE SUPPORT FOR THE MOST DISADVANTAGED

The last objective that the committee has adopted stems directly from the mandate that the government assigned to it. Within the context of its analysis of taxation, the committee must ensure that the proposed tax system **ensures the equitable redistribution of collective wealth and adequate support for the most disadvantaged.**

The committee believes that this objective must be regarded as a condition for the implementation of the preceding objectives.

The committee has ensured that the initiatives proposed in respect of the tax reform do not call into question the equitable redistribution of collective wealth and, particularly, adequate support for the most disadvantaged.

In the elaboration of its recommendations, the committee acknowledges the importance of pursuing the government's initiatives to combat poverty and social exclusion.

In its analyses, it has taken into account the repercussions of its recommendations on certain target groups and, in particular, on the financial situation of the most disadvantaged.

☐ The key role that taxation plays

The committee wishes to emphasize that taxation plays a key role in combating inequality and in better redistributing wealth, especially through the establishment of a progressive tax regime and the payment of socio-fiscal transfers.

However, it should be noted that several researchers agree that the fight against inequality hinges more on public expenditures and transfers than on taxation.[78] It is not the most progressive forms of taxation that best ensure redistribution. According to the researchers, the establishment of good public services and general social transfers appear to play a bigger role in the fight against inequality.

The committee is proposing a series of measures to ensure that the proposed reform does not call into question the equitable redistribution of collective wealth and, particularly, the maintenance of adequate support for the most disadvantaged:

- the enhancement of the solidarity tax credit;
- enhanced management of the solidarity tax credit;
- other proposals of the committee that enhance support for the most disadvantaged.

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[78] See, in particular, International Monetary Fund, *Fiscal Monitor*, October 2013, page 35, and the brief submitted to the committee by political analysts Olivier Jacques and Alain Noël.

8.1 The enhancement of the solidarity tax credit

The solidarity tax credit is one of the tax tools used to redistribute wealth in favour of low- and middle-income taxpayers. Since July 2011, the refundable tax credit has been granted to low- or middle-income households to offset the cost of the Québec sales tax (QST) and housing.

The tax credit is paid monthly and comprises three components:

— a component to compensate for the QST;

— a component aimed at households that assume eligible housing expenses;

— a component that recognizes the higher cost of living in Northern villages in Québec.

In 2012-2013, 2.6 million Québec households benefited from the tax credit and $1.7 billion was paid.

Recommendation 70

To protect the most disadvantaged against the deterioration of their financial situation that may result from the proposed new mix of taxes, the committee is proposing a $310-million enhancement of the parameters of the solidarity tax credit.

The committee recommends increases of:

— $75 of the base amount, i.e. a 27% enhancement in relation to the current base amount of $278;

— $75 of the spousal amount, i.e. a 27% enhancement in relation to the current spousal amount of $278;

— $50 of the additional amount for a person living alone, i.e. a 38% enhancement in relation to the current additional amount for a person living alone of $133.

Impact on the solidarity tax credit of an increase to 11% of the QST

Since July 2011, the solidarity tax credit has been granted to low- or middle-income households to mitigate the cost of the Québec sales tax (QST) and housing and recognizes that the cost of living is higher in Northern villages than elsewhere in Québec.

The tax credit is paid monthly and comprises three components:

- a component to compensate for the QST;
- a component aimed at households that assume eligible housing expenses;
- a component for individuals living in Northern villages.

The amounts pertaining to the QST component in 2015 are:

- $278 for the base amount;
- $278 for the spousal amount;
- $133 for the additional amount for a person living alone.

Using the Social Policy Simulation Database and Model, the Ministère des Finances has estimated the additional tax burden that low-income households would bear were the QST to be increased by 1.025 percentage points.

The annual impact on a person living alone would be roughly:

- $100 on total income of $20 000 or less;
- $130 on total income of $30 000 or less.

The annual impact for a childless couple would be roughly:

- $140 on total income of $20 000 or less;
- $150 on total income of $30 000 or less.

The increase in the solidarity tax credit of $75 of the base amount, $75 of the spousal amount and $50 of the additional amount for a person living alone would represent an additional annual cost on the order of $310 million.

8.2 Enhanced management of the solidarity tax credit

The committee has examined the Auditor General of Québec's analysis of the solidarity tax credit and acknowledges the importance of remedying the shortcomings noted in the administration of the credit.[79]

In particular, the Auditor General's report deplores that the process implemented does not include all of the controls necessary to determine the eligibility of households and ensure that the amounts paid to them correspond to the amounts to which they are entitled.

Recommendation 71

From the standpoint of the management of the solidarity tax credit, the committee recommends that the appropriate means be adopted to tackle the significant shortcomings identified recently.

In a brief submitted to the committee,[80] the Auditor General of Québec also informed the committee of other questions that it has analyzed over the years and that might be related to the committee's deliberations.

The committee's observations and recommendation presented in the preceding section concerning sound tax expenditure management tackle some of the concerns expressed by the Auditor General in his brief to the committee.

The committee is of the opinion that other concerns that the Auditor General expressed relate more to the application by Revenu Québec of tax rules.

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[79] Auditor General of Québec, *Rapport du Vérificateur général du Québec à l'Assemblée nationale pour l'année 2014-2015, Vérification de l'optimisation des ressources*, Spring 2014.

[80] The unabridged version of the brief appears in Volume 6 of this report.

The Auditor General of Québec's conclusions concerning the solidarity tax credit

In November 2014, the Auditor General of Québec made public his report focusing, in particular, on his investigation concerning the solidarity tax credit.

Below are his main observations:[1]

> While the Ministère des Finances du Québec's forecasts indicated that the solidarity tax credit would engender expenditures on the order of $1.35 billion in 2012, such expenditures stood at $1.71 billion.
>
> The Ministère des Finances du Québec did not analyze the possible scenarios before it selected the mode of operation of the tax credit and assigned its management to Revenu Québec. This exercise would, in particular, have made it possible to determine the risks inherent in the attainment of the objectives and an estimate of implementation and management costs.
>
> The Ministère des Finances du Québec did not consider all of the potential impacts of the changes to the parameters selected. Accordingly, it did not take into account the impacts of such changes on the number of households claiming to be eligible for the housing component, which increased from less than 1.2 million to more than 2 million households.
>
> The process that Revenu Québec implemented to administer the tax credit does not include all of the controls necessary to determine the eligibility of households and ensure that the amounts paid to them correspond to the amounts to which they are entitled. For example, according to Revenu Québec data, 34% of the 807 784 beneficiaries who claimed to be living alone were sharing their dwelling unit in March 2013. The Auditor General estimates that roughly $80 million appears to have been overpaid for one year. At the time that we were concluding our investigation, Revenu Québec was implementing controls to detect and remedy the situations.
>
> The data processing system, which cost $33.8 million at the time of delivery, does not adequately support the work processes related to the solidarity tax credit. Moreover, since the system was delivered, enhancements and updates totalling $6.7 million have been deemed necessary.
>
> Revenu Québec does not monitor the cost of managing the tax credit since it does not produce the management information that enables it to do so. In 2013-2014, management costs exceeded by roughly $3 million the approved costs. What is more, 192 full-time equivalents were used instead of the 154 initially planned.

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[1] Auditor General of Québec, *Rapport du Vérificateur général du Québec à l'Assemblée nationale pour l'année 2014-2015, Vérification de l'optimisation des ressources*, Spring 2014, page 3.

8.3 Other proposals of the committee that enhance support for the most disadvantaged

❑ An increase in the basic personal amount

In addition to the enhancement of the solidarity tax credit, the committee recommends that the basic personal amount be increased in order to raise to $18 000 the amount of income shielded from taxation, which is considerably higher than the figure of $14 281, below which a taxpayer does not pay tax.

By contrast, the low-income cutoff for a person living alone stood at roughly $17 000 in 2013, as calculated by the Centre d'étude sur la pauvreté et l'exclusion using the Market Basket Measure.

The low-income cutoff: the Market Basket Measure

The low-income cutoff for 2013 estimated by the Centre d'étude sur la pauvreté et l'exclusion was calculated based on the cut-offs published by Statistics Canada for 2011, which are the most recent data available. In 2011, the cut-off ranged from $15 545 to $16 573 depending on the region.

The Market Basket Measure defined by Employment and Social Development Canada and published by Statistics Canada is based on a basket of specific goods and services.

Its components seek to represent a level of consumption close to median expenditures for food, clothing, shoes and housing, bearing in mind certain categories of other expenditures such as furnishings, telephone, household products and recreation.

The cost of the goods and services included in the Market Basket Measure is calculated for a reference family comprising four people. It is then calculated for family units of all other sizes, using an equivalence scale. The Market Basket Measure takes into account existing differences in the cost of living between communities of all sizes in Canada.[1]

[1] See Centre d'étude sur la pauvreté et l'exclusion, *La pauvreté, les inégalités et l'exclusion sociale au Québec : état de situation 2013*, Gouvernement du Québec, 2014, page 9, and Statistics Canada, *Low Income Lines, 2011-2012*, Income Research Paper Series (75F0002M), No. 002.

❑ The reduction of the tax rates

The reduction in the rates of the first tax brackets in the tax rate schedule that the committee is proposing will benefit low-income taxpayers and all taxpayers.[81]

❑ The enhancement of the work premium

Furthermore, the committee's recommendations concerning the work premium would ensure an additional amount of roughly $107 million would benefit households with more modest incomes and, in particular, the most disadvantaged.

The rate of the work premium would be increased by 2 percentage points for childless households and by 2.5 percentage points for households with children. The enhancement that the committee is proposing would significantly affect household disposable income by more than $300 for a couple with two children and more than $150 for a person living alone. The enhancement of the work premium would benefit the most disadvantaged.

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[81] See page 56.

PART 3: THE REFORM ADJUSTED OVER TIME

In Part 3 of Volume 1 of its report, the committee examines the adjustment over time of the proposed reform.

The tax reform proposed to the government hinges on:

— the immediate tightening of tax expenditures in order to meet the targets set in Budget 2014-2015;

— short-, medium- and long-term tax reform.

1. THE IMMEDIATE TIGHTENING OF TAX EXPENDITURES IN ORDER TO MEET THE TARGETS SET IN BUDGET 2014-2015

1.1 The interim report

Pursuant to its mandate, the committee submitted to the Minister of Finance an interim report on October 31, 2014.[82]

The report sought to identify a series of immediate tightening measures in respect of tax expenditures that could be applied to ensure the attainment of the targets set in Budget 2014-2015.

The committee intentionally targeted a limited number of clear, easily understood measures in the interim report that comply with certain criteria:

- first target possible tightening measures concerning the corporate taxation system;
- for the measures affecting individuals, emphasize general measures concerning large numbers of individuals in order to distribute the effort demanded and thereby reduce the impact for each taxpayer;
- adopt measures that generate the amounts demanded within the requisite time limit.

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[82] The unabridged report submitted to the Minister of Finance is presented in Volume 4 of this report.

❑ The measures recommended

The following table indicates the seven measures, which met the targets set.

TABLE 10

Savings and additional revenues generated by the measures that the committee proposed in its interim report
(millions of dollars)

	2014-2015	2015-2016	2016-2017
Tightening of corporate tax expenditures			
– For large businesses, termination of full refundability of corporate tax credits	5	135	365
– Establish a minimum threshold respecting qualified expenditures for the research and development tax credit and the investment tax credit	1	25	45
– Terminate the enhancement of the research and development tax credits for private partnerships, research consortiums and university research	0	15	25
– Terminate the reduction in the rate of the tax on capital of insurance corporations applicable to personal insurance premiums	35	130	130
Measures to tighten tax expenditures pertaining to consumption taxes			
– Standardize at 9% the rate of the tax levied on automobile insurance premiums	34	135	136
Temporary measure concerning individuals			
– Postpone by one year the planned 2015 indexation of the main parameters of the personal income tax system	58	194	13
Additional revenue measure			
– Increase from 9.75% to 10% the rate of the QST	9	36	37
TOTAL	**142**	**670**	**751**

1.2 Recognition by the government of the committee's interim report in the *Update on Québec's Economic and Financial Situation*

On December 2, 2014, the government published the *Update on Québec's Economic and Financial Situation,* which presented the measures that the government adopted to achieve a return to a balanced budget.

The government acted upon four of the committee's seven recommendation, occasionally with adjustments. The government did not take action on three recommendations and it also announced measures that do not stem from the committee's recommendations.

The following table presents the tightening measures presented by the government in the *Update on Québec's Economic and Financial Situation* and that stem from the recommendations in the committee's interim report.

TABLE 11

Financial impact of the tax measures to restore budgetary balance from the December 2, 2014 *Update on Québec's Economic and Financial Situation* stemming from the recommendations in the committee's interim report
(millions of dollars)

	2014-2015	2015-2016	2016-2017
Measures pertaining to the corporate taxation system			
– Introduction of minimum expenditure thresholds eligible for the research and development tax credits and the investment tax credit	4	58	120
– Standardization of the rates of the research and development tax credits	—	5	15
– Abolition of the reduction in the rate of the capital tax paid by insurance corporations applicable to personal insurance premiums	42	128	130
Measures pertaining to consumption taxes			
– Abolition of the reduction in the rate of the tax on insurance premiums in respect of automobile insurance	34	135	136
TOTAL	**80**	**326**	**401**

2. A SHORT-, MEDIUM- AND LONG-TERM TAX REFORM

The committee is proposing a tax reform that hinges on short-, medium- and long-term changes.

2.1 In the short term

In the short term, the committee is proposing tax reform that would be at zero cost to the taxpayer and neutral for public finances.

This time horizon corresponds to the initiatives that Québec alone can implement.

☐ A reduction in personal and corporate income tax

The reform would consist in reducing personal and corporate income tax and the reduction would be financed by a revision of tax expenditures and a tax mix.

☐ A reform at zero cost

The reform would engender zero cost for individuals and corporations taken separately. The committee is of the opinion that this condition is essential to take into account the current level of taxation.

☐ A reform that is neutral for public finances

The reform would be neutral for public finances, which means that the proposed changes should be self-financing without either increasing or reducing the overall tax burden. The tax reform targeted by the committee is not intended to generate new revenues for the government.

The reform takes as its starting point the income tax position prevailing at the time of submission of the report, i.e. bearing in mind the announcements that the government made in the December 2, 2014 *Update on Québec's Economic and Financial Situation*.

2.2 In the medium and long term

In the medium and long term, the committee is proposing to the government to undertake changes in the tax system within a different time frame.

The medium-term horizon corresponds to the initiatives that require changes or coordination with the other Canadian provinces or the federal government. Since Québec cannot act alone, it would take longer to implement the measures.

The long-term horizon corresponds to the measures that also require thorough reflection.

☐ A review of the taxation of capital gains

The treatment of capital gains is subject to specific rules that are more favourable than the general tax regime.

The revision of the current method of taxation of capital gains would seek to treat more fairly capital gains compared with other sources of income. Such a revision would take time because of the coordination that it is imperative to carry out across Canada.

☐ The examination of a dual income tax system

Such a system could make the taxation of income more favourable to growth and a higher standard of living.

It would be a major reform that requires extensive preparation and thorough analyses in order to determine whether this avenue must in fact be emphasized.

☐ Two processes of reflection

Again in the medium and long term, the committee is inviting the government to establish processes of reflection on two other possible tax reforms:

- the broadening of the field of taxation of consumption;
- broaden reliance on eco-taxation.

☐ A reduction in the tax burden

An overall decrease in the tax burden can only be contemplated after budget surpluses have been achieved and insofar as the budgetary balance thus attained is deemed to be solid and durable. Once budgetary balance has been restored, the government has committed itself to devoting half of the surpluses available to reducing the tax burden.

The committee believes that were the government to achieve such surpluses, it should partly use them to lower the tax burden and along the same lines as the proposed tax reform.

The return to a balanced budget: prudent management before possible surpluses

Once budgetary balance has been restored, the government should in its multi-year budget planning ensure that it allows a sufficient margin for contingencies to handle economic vagaries.

Accordingly, the margin should be taken into account before the use is contemplated of the surpluses that can be used to reduce the tax burden.

PART 4:
AN ESTIMATE OF THE ANTICIPATED IMPACT

In Part 4 of Volume 1 of its report, the committee presents estimates of the anticipated impact of the reform proposed to the government.

Below are estimates of the impact of the reform on:

— individuals; and on

— corporations.

1. AN ESTIMATE OF THE IMPACT OF THE REFORM ON INDIVIDUALS

The committee has estimated the anticipated impact of the reform on different groups of individuals.

Below are estimates of the impact of the reform on:

— families;

— persons living alone;

— childless couples;

— seniors.

☐ The hypotheses adopted

At the committee's request, the Ministère des Finances produced an estimate of the impact of the reform proposed to the government using simulation tools to quantify the impacts for taxpayers of the key recommendations that the committee has formulated.

■ The households selected

In the case of individuals, the committee has adopted 10 types of households:

— couples with one preschool-aged child;

— couples with two preschool-aged children;

— couples with two school-aged childred;

— single-parent families with one preschool-aged child;

— single-parent families with one school child;

— persons living alone;

— childless couples;

— seniors couples 60 years of age who earn income from remunerated work;

— seniors couples 65 years of age who earn income from remunerated work;

— seniors couples 65 years of age in which only one spouse receives pension income.

■ The changes to the tax rules whose impacts were simulated

The estimated impacts of the committee's proposed reform take into account the changes that would, when applied, have the biggest repercussions on the disposable income of different types of households.

The changes are indicated below:

- the modification of the tax rate schedule from four to nine tax brackets, the increase in the basic personal amount, and the abolition of the healthcare contribution;
- the abolition of the deduction for workers;
- the enhancement of the tax credit for the work premium;
- the introduction of a new premium for experienced workers to replace the existing refundable tax credit for experienced workers;
- changes in the provisions respecting the splitting of retirement income and the transfer between spouses of unused tax credits;
- changes to the refundable tax credit for child assistance;
- changes to the user fees for reduced-contribution childcare services;
- the enhancement of the solidarity tax credit;
- the increase in the QST rate.

The simulations did not take into account the other recommendations since their impact can vary considerably from one household to the next depending on individuals' circumstances and the choices that they make concerning the goods and services that they consume or their work or saving habits.

This is true, in particular, of the increase in the price of heritage pool electricity that the committee is recommending. As we saw earlier, the average annual electricity bill would increase by $108 for a five-and-a-half room dwelling unit and by $664 for a large house.

1.1 An estimate of the impact of the reform on families

At the committee's request, the simulations that the Ministère des Finances conducted to quantify the impact on the disposable income of households with preschool-aged children focused on two scenarios:

- the first scenario does not take into account the committee's recommendations concerning the fiscalization of the reduced-contribution childcare services rate;

- the second scenario takes into account the taxation of the reduced-contribution childcare rate.

Couples with preschool-aged children

Couples with one child

The purpose was to explicitly ascertain the impact of the committee's recommendations concerning the taxation of childcare services user fees.

- **Without the committee's recommendations concerning user fees for childcare services**

Without taking into account the committee's recommendation concerning childcare services, all couples with one preschool-aged child would benefit.

Households with work income between $60 000 and $100 000 would be the biggest beneficiaries with gains ranging from $1 359 and $1 601.

Tax cuts, including the abolition of the healthcare contribution, would offset the losses stemming from the elimination of the refundable tax credit for child assistance for well-to-do families and the increase in the QST rate.

TABLE 12

Change in disposable income for a couple with a 3-year-old child and two equal incomes – without taking into account the proposed changes to the reduced-contribution childcare services rate
($)

	Tax payable			Refundable tax credits								
Work income	Tax[1]	Deduction for workers[2]	Subtotal	Work premium	Solidarity tax credit	Child assistance	Childcare expenses	Subtotal	Healthcare contribution	QST	Total	*% of Income*[3]
20 000	—	–120	**–120**	311	150	—	—	**461**	—	–164	**177**	***0.89***
40 000	1 264	–784	**480**	311	150	—	—	**461**	163	–228	**875**	***2.19***
60 000	1 648	–426	**1 222**	—	—	207	—	**207**	200	–270	**1 359**	***2.27***
80 000	1 654	–546	**1 108**	—	—	377	—	**377**	200	–322	**1 362**	***1.70***
100 000	1 909	–474	**1 435**	—	—	137	—	**137**	400	–371	**1 601**	***1.60***
150 000	2 099	–543	**1 557**	—	—	–664	—	**-664**	400	–480	**813**	***0.54***
200 000	1 806	–538	**1 268**	—	—	–664	—	**-664**	400	–594	**411**	***0.21***

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.
(2) The abolition of the deduction for workers, including the impact on refundable tax credits and required contributions.
(3) The percentage of income is calculated on work income.

- **Taking into account the committee's recommendations concerning user fees for childcare services**

Bearing in mind the changes to reduced-contribution childcare services, the increases in disposable income would vary between $1 939 and $2 676 for couples with one child and combined work income between $40 000 and $100 000.

In the case of families with work income between $40 000 and $60 000, the gain represents between 4.00% and 6.29% of work income.

As for the recommendations concerning childcare services user fees, the proposed changes mean that low- or middle-income families would benefit from a lower net cost while the cost would increase only for those with higher incomes.

TABLE 13

Change in disposable income for a couple with a 3-year-old child and two equal incomes – taking into account the proposed changes to the reduced-contribution childcare services rate
($)

	Tax payable			**Refundable tax credits**								
Work income	**Tax**[1]	**Deduction for workers**[2]	**Subtotal**	**Work premium**	**Solidarity tax credit**	**Child assistance**	**Childcare expenses**[3]	**Subtotal**	**Healthcare contribution**	**QST**	**Total**	***% of income***[4]
20 000	—	–120	**–120**	311	150	—	–2	**459**	—	–164	**175**	***0.88***
40 000	1 264	–784	**480**	311	150	—	1 639	**2 100**	163	–228	**2 514**	***6.29***
60 000	1 648	–426	**1 222**	—	—	207	1 040	**1 247**	200	–270	**2 399**	***4.00***
80 000	1 654	–546	**1 108**	—	—	377	577	**953**	200	–322	**1 939**	***2.42***
100 000	1 909	–474	**1 435**	—	—	137	1 075	**1 212**	400	–371	**2 676**	***2.68***
150 000	2 099	–543	**1 557**	—	—	–664	–665	**–1 329**	400	–480	**148**	***0.10***
200 000	1 806	–538	**1 268**	—	—	–664	–952	**–1 616**	400	–594	**–541**	***–0.27***

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.

(2) The abolition of the deduction for workers, including the impact on refundable tax credits, required contributions and the adjusted childcare services rate.

(3) Comparison of the scenario that the committee proposed and the announcement made in the *Update on Québec's Economic and Financial Situation* including the impact on the federal child care expense deduction.

(4) The percentage of income is calculated on work income.

Couples with two children

Without the committee's recommendations concerning user fees for childcare services

Without taking into account the committee's recommendations concerning user fees for childcare services, all couples with two preschool-aged children and income under $200 000 would come out ahead.

Households with work income between $60 000 and $100 000 would be the biggest beneficiaries with gains ranging from $1 274 to $1 887.

TABLE 14

Change in disposable income for a couple with two children 3 and 4 years of age and two equal incomes – without taking into account the proposed changes to the reduced-contribution childcare services rate
($)

	Tax payable			Refundable tax credits								
Work income	**Tax[1]**	**Deduction for workers[2]**	**Subtotal**	**Work premium**	**Solidarity tax credit**	**Child assistance**	**Childcare expenses**	**Subtotal**	**Healthcare contribution**	**QST**	**Total**	***% of income[3]***
20 000	—	–120	**–120**	311	150	—	—	**461**	—	–189	**152**	***0.76***
40 000	1 302	–784	**518**	311	150	—	—	**461**	163	–256	**886**	***2.22***
60 000	1 648	–426	**1 222**	—	—	207	—	**207**	200	–288	**1 341**	***2.24***
80 000	1 647	–618	**1 029**	—	—	377	—	**377**	200	–332	**1 274**	***1.59***
100 000	1 947	–630	**1 317**	—	—	547	—	**547**	400	–378	**1 887**	***1.89***
150 000	2 061	–615	**1 446**	—	—	–869	—	**-869**	400	–467	**510**	***0.34***
200 000	1 818	–538	**1 280**	—	—	–1 277	—	**–1 277**	400	–578	**–174**	***–0.09***

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.
(2) The abolition of the deduction for workers, including the impact on refundable tax credits and required contributions.
(3) The percentage of income is calculated on work income.

- **Taking into account the committee's recommendations concerning user fees for childcare services**

Bearing in mind the committee's recommendation concerning childcare services user fees, households with work income between $40 000 and $100 000 would be the biggest beneficiaries, with gains ranging from $2 656 to $4 343.

In the case of families with work income between $40 000 and $60 000, the gain represents between 6.99% and 10.86% of work income.

TABLE 15

Change in disposable income for a couple with two children 3 and 4 years of age and two equal incomes – taking into account the proposed changes to the reduced-contribution childcare services rate
($)

	Tax payable			Refundable tax credits								
Work income	**Tax[1]**	**Deduction for workers[2]**	**Subtotal**	**Work premium**	**Solidarity tax credit**	**Child assistance**	**Childcare expenses[3]**	**Subtotal**	**Healthcare contribution**	**QST**	**Total**	***% of Income[4]***
20 000	—	–120	**–120**	311	150	—	–4	**457**	—	–189	**148**	***0.74***
40 000	1 302	–784	**518**	311	150	—	3 457	**3 918**	163	–256	**4 343**	***10.86***
60 000	1 648	–426	**1 222**	—	—	207	2 853	**3 060**	200	–288	**4 194**	***6.99***
80 000	1 647	–618	**1 029**	—	—	377	1 382	**1 759**	200	–332	**2 656**	***3.32***
100 000	1 947	–630	**1 317**	—	—	547	2 220	**2 767**	400	–378	**4 107**	***4.11***
150 000	2 061	–615	**1 446**	—	—	–869	–1 330	**–2 199**	400	–467	**–820**	***–0.55***
200 000	1 818	–538	**1 280**	—	—	–1 277	–1 913	**–3 190**	400	–578	**–2 087**	***–1.04***

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.

(2) The abolition of the deduction for workers, including the impact on refundable tax credits, required contributions and the adjusted childcare services rate.

(3) Comparison of the scenario that the committee proposed and the announcement in the *Update on Québec's Economic and Financial Situation* including the impact on the federal child care expense deduction.

(4) The percentage of income is calculated on work income.

❑ Couples with two school-aged childred

The proposed reform would have a positive impact on couples with two school-aged childred in all income brackets, except for couples that earn work income of $200 000 or more.

As a proportion of income, the main beneficiaries would be couples with work income between $40 000 and $100 000, with gains ranging from $853 to $1 971.

TABLE 16

Change in disposable income for a couple with two children 7 and 9 years of age and two equal incomes
($)

	Tax payable			Refundable tax credits							
Work income	Tax[1]	Deduction for workers[2]	Subtotal	Work premium	Solidarity tax credit	Child assistance	Subtotal	Healthcare contribution	QST	Total	*% of income*[3]
20 000	—	–120	**–120**	311	150	—	**461**	—	–195	**147**	***0.74***
40 000	1 254	–784	**470**	311	150	—	**461**	163	–242	**853**	***2.13***
60 000	1 648	–426	**1 222**	—	—	207	**207**	200	–283	**1 346**	***2.24***
80 000	1 664	–470	**1 194**	—	—	377	**377**	200	–336	**1 435**	***1.79***
100 000	1 899	–493	**1 406**	—	—	547	**547**	400	–382	**1 971**	***1.97***
150 000	2 109	–470	**1 639**	—	—	–869	**–869**	400	–500	**669**	***0.45***
200 000	1 806	–538	**1 268**	—	—	–1 277	**–1 277**	400	–612	**–221**	***–0.11***

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.
(2) The abolition of the deduction for workers, including the impact on refundable tax credits and required contributions.
(3) The percentage of income is calculated on work income.

❑ Single-parent families

▪ Without the committee's recommendations concerning user fees for childcare services

Without taking into account the committee's recommendation concerning reduced-contribution childcare services user fees, all single-parent families with one preschool-aged child would come out ahead.

The gains would be highest for families with work income between $60 000 and $80 000, with gains ranging from $980 to $1 026.

Tax cuts, including the abolition of the healthcare contribution, would offset the losses stemming from the elimination of the refundable tax credit for child assistance for well-to-do families and the increase in the QST rate.

TABLE 17

Change in disposable income for a single-parent family with a 3-year-old child – without taking into account the proposed changes to the reduced-contribution childcare services rate
($)

	Tax payable			**Refundable tax credits**								
Work income	**Tax[1]**	**Deduction for workers[2]**	**Subtotal**	**Work premium**	**Solidarity tax credit**	**Child assistance**	**Childcare expenses**	**Subtotal**	**Healthcare contribution**	**QST**	**Total**	***% of income[3]***
20 000	651	–269	**382**	199	125	—	—	**324**	—	–152	**555**	***2.78***
40 000	819	–347	**472**	—	125	111	—	**236**	100	–204	**604**	***1.51***
60 000	1 058	–269	**789**	—	—	281	—	**281**	200	–244	**1 026**	***1.71***
80 000	942	–326	**615**	—	—	451	—	**451**	200	–287	**980**	***1.23***
100 000	903	–303	**600**	—	—	194	—	**194**	200	–325	**670**	***0.67***
150 000	1 442	–367	**1 076**	—	—	–995	—	**–995**	894	–393	**582**	***0.39***
200 000	1 442	–288	**1 154**	—	—	–995	—	**–995**	1 000	–453	**706**	***0.35***

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.
(2) The abolition of the deduction for workers, including the impact on refundable tax credits and required contributions.
(3) The percentage of income is calculated on work income.

- **Taking into account the committee's recommendations concerning user fees for childcare services**

Taking into account the committee's recommendations concerning user fees for childcare services, a single-parent family with one child in a reduced-contribution childcare service and work income between $40 000 and $60 000 would obtain a tax cut, higher child assistance and a reduction in the net cost of childcare services such that disposable income would increase between $2 243 and $2 412.

As a proportion of income, the value of the proposed changes would have greater impact on lower incomes. On work income of $20 000, the gain would represent a 7.52% increase in work income.

TABLE 18

Change in disposable income for a single-parent family with a 3-year-old child – taking into account the proposed changes to the reduced-contribution childcare services rate
($)

	Tax payable			Refundable tax credits								
Work income	**Tax[1]**	**Deduction for workers[2]**	**Subtotal**	**Work premium**	**Solidarity tax credit**	**Child assistance**	**Childcare expenses[3]**	**Subtotal**	**Healthcare contribution**	**QST**	**Total**	***% of income[4]***
20 000	651	–269	**382**	199	125	—	949	**1 273**	—	–152	**1 504**	***7.52***
40 000	819	–347	**472**	—	125	111	1 639	**1 875**	100	–204	**2 243**	***5.61***
60 000	1 058	–269	**789**	—	—	281	1 386	**1 667**	200	–244	**2 412**	***4.02***
80 000	942	–326	**615**	—	—	451	911	**1 363**	200	–287	**1 891**	***2.36***
100 000	903	–303	**600**	—	—	194	1 247	**1 441**	200	–325	**1 917**	***1.92***
150 000	1 442	–367	**1 076**	—	—	–995	–490	**–1 485**	894	–393	**92**	***0.06***
200 000	1 442	–288	**1 154**	—	—	–995	–882	**–1 877**	1 000	–453	**–176**	***–0.09***

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.

(2) The abolition of the deduction for workers, including the impact on refundable tax credits, required contributions and the adjusted childcare services rate.

(3) Comparison of the scenario that the committee proposed and the announcement in the *Update on Québec's Economic and Financial Situation* including the impact on the federal child care expense deduction.

(4) The percentage of income is calculated on work income.

- **A single-parent family with a 7-year-old child**

In the case of single-parent families with a school child, no family would have less disposable income following the implementation of the reform.

The gain would be higher for families with work income between $60 000 and $80 000, with a gain of roughly $1 030.

Low-income families would pay less tax and receive more in the form of the work premium, child assistance and the solidarity tax credit.

TABLE 19

Change in the disposable income for a single-parent family with a 7-year-old child
($)

	Tax payable			Refundable tax credits							
Work income	**Tax**[1]	**Deduction for workers**[2]	**Subtotal**	**Work premium**	**Solidarity tax credit**	**Child assistance**	**Subtotal**	**Healthcare contribution**	**QST**	**Total**	***% of income***[3]
20 000	583	–225	**358**	199	125	—	**324**	—	–151	**531**	***2.66***
40 000	835	–339	**496**	—	125	111	**236**	100	–199	**633**	***1.58***
60 000	1 058	–269	**789**	—	—	281	**281**	200	–242	**1 029**	***1.71***
80 000	966	–291	**674**	—	—	451	**451**	200	–288	**1 038**	***1.30***
100 000	903	–269	**634**	—	—	194	**194**	200	–326	**702**	***0.70***
150 000	1 439	–330	**1 109**	—	—	–995	**–995**	894	–403	**605**	***0.40***
200 000	1 442	–288	**1 154**	—	—	–995	**–995**	1 000	–461	**697**	***0.35***

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.
(2) The abolition of the deduction for workers, including the impact on refundable tax credits and required contributions.
(3) The percentage of income is calculated on work income.

1.2 An estimate of the impact of the reform on persons living alone

The proposed reform would have a positive impact on persons living alone in all income brackets.

Taxpayers with the highest incomes would enjoy the biggest gain. On work income between $20 000 and $100 000, the gain would range from $520 to $834. On earnings of $150 000, it would rise to $1 601. However, as a proportion of work income, the gains would be fairly uniform and even slightly greater among individuals with lower incomes.

For persons living alone with incomes between $150 000 and $200 000, the elimination of the healthcare contribution would represent 56% to 60% of the gains stemming from the recommendations.

TABLE 20

Change in disposable income for a person living alone
($)

	Tax payable			Refundable tax credits						
Work income	Tax[1]	Deduction for workers[2]	Subtotal	Work premium	Solidarity tax credit	Subtotal	Healthcare contribution	QST	Total	% of income[3]
20 000	468	–68	**400**	—	125	**125**	82	–86	**520**	***2.60***
40 000	835	–280	**555**	—	125	**125**	100	–147	**633**	***1.58***
60 000	1 058	–224	**834**	—	—	—	200	–199	**834**	***1.39***
80 000	980	–246	**734**	—	—	—	200	–253	**681**	***0.85***
100 000	903	–269	**634**	—	—	—	200	–300	**535**	***0.54***
150 000	1 434	–325	**1 109**	—	—	—	894	–402	**1 601**	***1.07***
200 000	1 442	–288	**1 154**	—	—	—	1 000	–492	**1 662**	***0.83***

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.
(2) The abolition of the deduction for workers, including the impact on refundable tax credits and required contributions.
(3) The percentage of income is calculated on work income.

1.3 An estimate of the impact of the reform on childless couples

Childless couples would enjoy positive gains in all income brackets.

Couples with work income between $60 000 and $150 000 would obtain the highest gains, ranging from $1 207 to $1 590.

TABLE 21

Change in disposable income for a childless couple
($)

	Tax payable			Refundable tax credits						
Work income	**Tax**[1]	**Deduction for workers**[2]	**Subtotal**	**Work premium**	**Solidarity tax credit**	**Subtotal**	**Healthcare contribution**	**QST**	**Total**	***% of income***[3]
20 000	—	–120	**–120**	249	150	**399**	—	–122	**157**	***0.79***
40 000	1 225	–560	**665**	—	150	**150**	163	–188	**790**	***1.98***
60 000	1 625	–314	**1 312**	—	—	—	200	–246	**1 266**	***2.11***
80 000	1 670	–358	**1 312**	—	—	—	200	–304	**1 207**	***1.51***
100 000	1 870	–403	**1 467**	—	—	—	400	–355	**1 512**	***1.51***
150 000	2 115	–448	**1 667**	—	—	—	400	–477	**1 590**	***1.06***
200 000	1 806	–538	**1 268**	—	—	—	400	–587	**1 081**	***0.54***

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.
(2) The abolition of the deduction for workers, including the impact on refundable tax credits and required contributions.
(3) The percentage of income is calculated on work income.

1.4 An estimate of the impact of the reform on seniors

☐ A couple in which both spouses are 60 years of age with work income

The proposed reform would have a positive impact on couples in which both spouses are 60 years of age with work income, in all income brackets.

The increases in disposable income would range from $1 649 to $4 252 for couples with work income between $20 000 and $80 000. As a percentage of work income, the gain would be especially significant for couples with work income between $20 000 and $60 000. The gains would represent between 7.09% and 9.44% of work income.

The new tax rate schedule would be favourable: such seniors would pay less tax and the healthcare contribution would be abolished, but above all, the benefits stemming from the new premium for experienced workers would largely offset the abolition of the deduction for workers.

TABLE 22

Change in the disposable income of a couple in which both spouses are 60 years of age with equal work incomes
($)

	Tax payable			Refundable tax credits							
Work income	Tax[1]	Deduction for workers[2]	Subtotal	Work premium	Solidarity tax credit	Experienced workers[3]	Subtotal	Healthcare contribution	QST	Total	*% of income*[4]
20 000	—	–120	**–120**	249	150	1 500	**1 899**	—	–130	**1 649**	***8.25***
40 000	1 225	–560	**665**	—	150	3 000	**3 150**	163	–203	**3 776**	***9.44***
60 000	1 625	–314	**1 311**	—	—	3 000	**3 000**	200	–260	**4 252**	***7.09***
80 000	1 670	–358	**1 312**	—	—	1 000	**1 000**	200	–309	**2 203**	***2.75***
100 000	1 870	–403	**1 467**	—	—	—	—	400	–355	**1 512**	***1.51***
150 000	2 115	–448	**1 667**	—	—	—	—	400	–477	**1 590**	***1.06***
200 000	1 806	–538	**1 268**	—	—	—	—	400	–587	**1 081**	***0.54***

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.
(2) The abolition of the deduction for workers, including the impact on refundable tax credits and required contributions.
(3) Including the abolition of the non-refundable tax credit for experienced workers.
(4) The percentage of income is calculated on work income.

☐ A couple in which both spouses are 65 years of age with work income

The impact of the proposed reform on couples in which both spouses are 65 years of age would be especially significant for those whose work income is between $20 000 and $80 000, with gains ranging from $2 370 to $4 985.

As a percentage of work income, the gain would be particularly significant for couples with work income between $20 000 and $60 000. The gains would represent between 7.09% and 9.44% of work income and between 8.31% and 11.85% of earnings.

For couples who earn between $20 000 and $80 000, the impact of the premium for experienced workers would be especially significant and explains a large part of the gains obtained.

TABLE 23

Change in the disposable income of a couple in which both spouses are 65 years of age with equal work incomes
($)

	Tax payable				Refundable tax credits							
Work income	Tax[1]	Deduction for workers[2]	Retirement income and age-related income	Subtotal	Work premium	Solidarity tax credit	Experienced workers[3]	Subtotal	Healthcare contribution	QST	Total	% of income[4]
20 000	—	–96	—	**-96**	—	150	2 500	**2 650**	24	–208	**2 370**	*11.85*
40 000	1 497	–422	–371	**704**	—	134	3 720	**3 854**	200	–266	**4 491**	*11.23*
60 000	1 670	–282	—	**1,388**	—	—	3,720	**3 720**	200	–323	**4 985**	*8.31*
80 000	1 742	–326	—	**1,416**	—	—	1 720	**1 720**	400	–366	**3 170**	*3.96*
100 000	2 115	–371	—	**1 744**	—	—	–280	**–280**	400	–402	**1 462**	*1.46*
150 000	1 942	–416	—	**1,526**	—	—	–1 280	**–1 280**	400	–503	**144**	*0.10*
200 000	1 806	–461	—	**1 345**	—	—	–1 280	**–1 280**	400	–594	**–129**	*–0.06*

(1) Includes the change to the tax rate schedule and the increase in the basic personal amount.
(2) The abolition of the deduction for workers, including the impact on refundable tax credits and required contributions.
(3) Including the abolition of the non-refundable tax credit for experienced workers.
(4) The percentage of income is calculated on work income.

❑ A couple in which both spouses are 65 years of age with pension income

In the case of couples in which both spouses are 65 years of age who have left the labour force and in which only one spouse receives pension income, the estimated gains stemming from the committee's recommendations would be positive but fairly modest for those with total income of $100 000 or less. The gains would range from $62 to $995.

The disposable income of other couples would decrease, above all because of the tightening measures that the committee is recommending respecting the splitting of retirement income and the transfer between spouses of unused tax credits. However, such losses would be small as a percentage of pension income, ranging from 0.92% to 1.21%.

As a proportion of income, the value of the proposed changes would be higher on family incomes between $40 000 and $60 000. Beyond $60 000, the value measured as a percentage of pension income would gradually decline and only represent 0.16% at $100 000 of family income.

TABLE 24

Change in the disposable income of a couple in which both spouses are 65 years of age and only one spouse has pension income
($)

	Tax payable					Refundable tax credits					
Pension income	Tax[1]	Income and age-related income	Splitting of retirement income	*Other*[2]	Subtotal	Solidarity tax credit	Subtotal	Healthcare contribution	QST	Total	*% of income*[3]
20 000	—	—	—	—	**—**	150	**150**	100	–188	**62**	***0.31***
40 000	1 152	–808	—	—	**344**	134	**134**	200	–244	**434**	***1.08***
60 000	1 316	–208	–16	—	**1 093**	—	—	200	–298	**995**	***1.66***
80 000	1 156	—	–269	—	**887**	—	—	200	–342	**745**	***0.93***
100 000	1 162	—	–819	—	**343**	—	—	200	–380	**163**	***0.16***
150 000	1 701	—	–2 546	–954	**–1 799**	—	—	894	–477	**–1 382**	***–0.92***
200 000	1 701	—	–3 095	–1 457	**–2 851**	—	—	1 000	–571	**–2 422**	***–1.21***

Note: Assuming that only one spouse receives pension income alone and that the other spouse has no income.
(1) The abolition of the deduction for workers, including the impact on refundable tax credits and required contributions.
(2) Including the abolition of the non-refundable tax credit for experienced workers.
(3) The percentage of income is calculated on work income.

2. AN ESTIMATE OF THE IMPACT OF THE REFORM ON CORPORATIONS.

At the committee's request, the Ministère des Finances conducted simulations to illustrate the impact of the reform that it is proposing on the corporate taxation system.

Depending on the type of enterprise, the impact can vary considerably, in particular because of its area of activity, size and profitability. To illustrate the impacts of the proposed reform, the tax effects are presented for the following types of enterprises:

- a taxable corporation in the processing sector;
- a non-taxable corporation in the processing sector;
- a small company in the service sector with more than five employees;
- a professional who is practising through a corporation.

❑ A taxable corporation in the processing sector

In the following example, the impacts of the proposed reform would be positive. The corporation's tax net of tax credits would decrease by $41 360. When the increase in the cost of electricity is included, the overall reduction would be $7 760.

In particular, the corporation would:

— be subject to a 1.9-percentage-point decrease in its income-tax rate;

— obtain the same amount of tax credit given that its income tax and contribution to the Health Services Fund (HSF) exceeds the level of the tax credits;

— would pay $33 600 more for electricity.

However, such impact would be lower than the gain in corporate tax.

TABLE 25

Illustration of the impacts of the committee's recommendations on a large taxable corporation in the processing sector
(in dollars, unless otherwise indicated)

	Current	After the recommendations	Difference
Contribution to the HSF			
Total payroll	5 000 000	5 000 000	—
Contribution rate	*4.26%*	*4.26%*	
Contribution to the HSF payable	**213 000**	**213 000**	—
Income tax			
Sales	**20 000 000**	**20 000 000**	—
Less:			
– Total payroll	5 000 000	5 000 000	—
– Electricity[1]	267 000	300 600	33 600
– Contribution to the HSF	213 000	213 000	—
– Other expenses and deductions	12 520 000	12 520 000	—
Taxable income	**2 000 000**	**1 966 400**	**–33 600**
Taxation rate	*11.9%*	*10.0%*	
Income tax payable	**238 000**	**196 640**	**–41 360**
Tax credit			
Refundable amount	–100 000	—	–100 000
Non-refundable amount	0	–100 000	100 000
Tax credit received	**–100 000**	**–100 000**	**0**
Tax burden net of tax credits	**351 000**	**309 640**	**–41 360**
Increase in the cost of electricity	0	33 600	33 600
Impact of the reform	**351 000**	**343 240**	**–7 760**

Note: Illustration for a corporation with sales of $20 million and a ratio of taxable income to sales of 10%.
(1) Based on the average electricity expense as a percentage of sales in the processing sector.

☐ A non-taxable corporation in the processing sector

In this example, the impacts of the proposed reform would be negative even if the tax burden net of tax credits remained unchanged for the corporation.

In particular, the corporation:

— would not benefit from a tax cut since its taxable income is zero;

— would pay $33 600 more for electricity.

TABLE 26

Illustration of the impacts of the committee's recommendations on a non-taxable corporation in the processing sector
(in dollars, unless otherwise indicated)

	Current	After the recommendations	Difference
Contribution to the HSF			
Total payroll	5 000 000	5 000 000	—
Contribution rate	*4.26%*	*4.26%*	
Contribution to the HSF payable	**213 000**	**213 000**	—
Income tax			
Sales	**20 000 000**	**20 000 000**	—
Less:			
– Total payroll	5 000 000	5 000 000	—
– Electricity[1]	267 000	300 600	33 600
– Contribution to the HSF	213 000	213 000	—
– Other expenses and deductions	14 520 000	14 520 000	—
Taxable income	—	**−33 600**	**−33 600**
Taxation rate	*11.9%*	*10.0%*	
Income tax payable	—	—	—
Tax credit			
Refundable amount	−100 000	—	−100 000
Non-refundable amount	—	-100,000	100 000
Tax credit received	**−100 000**	**−100 000**	—
Tax burden net of tax credits	**113 000**	**113 000**	—
Increase in the cost of electricity	—	33 600	33 600
Impact of the reform	**113 000**	**146 600**	**33 600**

Note: Illustration for an unprofitable business that has sales of $20 million.
(1) Based on the average electricity expense as a percentage of sales in the processing sector.

☐ A small company in the service sector with more than five employees

In the following example, the impacts of the proposed reform would be positive. The corporation's tax burden net of tax credits would decrease by $7 399. When the increase in the cost of electricity is included, the overall reduction would be $4 419. In particular, the corporation:

- would benefit from a reduction or more than 40% in its contribution to the Health Services Fund;
- be subject to a 1.04-percentage-point decrease in its income-tax rate with the "growth premium";
- would continue to benefit from refundable tax credits;
- would pay $2 980 more for electricity.

However, such impact would be lower than the gain in corporate tax and with respect to the contribution to the Health Services Fund.

TABLE 27

Illustration of the impacts of the committee's recommendations on a small company in the service sector with more than five employees
(in dollars, unless otherwise indicated)

	Current	After the recommendations	Difference
Contribution to the HSF			
Total payroll	500 000	500 000	—
Contribution rate	*2.7%*	*1.6%*	
Contribution to the HSF payable	**13 500**	**8 000**	**–5 500**
Income tax			
Sales	4 000 000	4 000 000	—
Less:			
– Total payroll	500 000	500 000	—
– Electricity[1]	23 600	26 580	2 980
– Contribution to the HSF	13 500	8 000	–5 500
– Other expenses and deductions	3 262 900	3 262 900	—
Taxable income	**200 000**	**202 520**	**2 520**
Taxation rate	*8.0%*	*6.96%*[2]	
Income tax payable	**16 000**	**14 101**	**–1 899**
Tax credit			
Refundable amount	–5 000	–5 000	—
Non-refundable amount	—	—	—
Tax credit received	**–5 000**	**–5 000**	—
Tax burden net of tax credits	**24 500**	**17 101**	**–7 399**
Increase in the cost of electricity	—	2 980	2 980
Impact of the reform	**24 500**	**20 081**	**–4 419**

Note: Illustration for a corporation with $4 million in sales and a taxable-income-to-sales ratio of 5%.
(1) Based on the average electricity expense as a percentage of sales in the business services sector.
(2) The marginal rate is 10% on taxable income between $0 and $100 000 and 4% on taxable income between $100 000 and $500 000.

An estimate of the impacts of the reform on a professional practising through a corporation

In the following example, the impacts of the proposed reform for a professional practising through a corporation would be negative. The corporation's tax burden would increase by $3 462. When the increase in the cost of electricity is included, the overall impact would be $4 092.

In particular, the corporation would:

— be subject to a 2-percentage-point increase in its income-tax rate;

— pay $630 more for electricity.

The corporation would, however, benefit from a reduction of more than $2 750 in its contribution to the Health Services Fund, which would partly offset the impact on corporate income tax and the level of electricity rates.

TABLE 28

Illustration of the impacts of the committee's recommendations on a professional practising through a corporation
(in dollars, unless otherwise indicated)

	Current	After the recommendations	Difference
Contribution to the HSF			
Total payroll	250 000	250 000	—
Contribution rate	2.7%	1.6%	
Contribution to the HSF payable	**6 750**	**4 000**	**–2 750**
Income tax			
Sales	750 000	750 000	—
Less:			
– Total payroll	250 000	250 000	—
– Electricity[1]	5 000	5 630	630
– Contribution to the HSF	6 750	4 000	–2 750
– Other expenses and deductions	188 250	188 250	—
Taxable income	**300 000**	**302 120**	**2 120**
Taxation rate	8.0%	10.0%	
Income tax payable	**24 000**	**30 212**	**6 212**
Tax credit			
Refundable amount	—	—	—
Non-refundable amount	—	—	—
Tax credit received	—	—	—
Tax burden net of tax credits	**30 750**	**34 212**	**3 462**
Increase in the cost of electricity	—	630	630
Impact of the reform	**30 750**	**34 842**	**4 092**

Note: Illustration for a corporation with sales of $750 000 and a taxable-income-to-sales ratio of 40%.
(1) Based on the average electricity expense as a percentage of sales in the office of a professional.

❑ The general tax rate

To enhance the competitiveness of the taxation system in respect of corporate income, the committee is proposing to reduce to 10% the corporate tax rate. Québec would thus offer, with Alberta, the most competitive tax rate in Canada and the rate would be nearly 3 percentage points below the Canadian average.

The reduction in the tax rate would benefit roughly 90 000 enterprises.

Such a reduction in the tax rate would promote business investment in Québec by increasing the return on such investments in all sectors of the economy.

❑ SMEs

■ A "growth premium"

Instead of simply applying a lower tax rate to SMEs, the committee recommends that a "growth premium" be implemented for them. The measure would offer a competitive taxation system in relation to the other Canadian provinces in all sectors without distinction.

On taxable income between $100 000 and $500 000, SMEs would pay a marginal rate of 4%.

— The reduction in the tax rate for SMEs would benefit nearly 20 000 enterprises.

— The marginal tax rate would be lower than the current 8% rate, lower than the 4.5% rate in force in Ontario and near the 3% average rate applied by the Canadian provinces, excluding Québec.

At the same time, the new premium would encourage SMEs to grow in order to reach levels of income that benefit from favourable tax treatment.

■ A reduction in the payroll tax

Furthermore, SMEs would benefit from the reduction in the payroll tax.

At present, the Québec taxation system is noteworthy for its heavy payroll tax in relation to the other three provinces in which such a tax exists. The payroll tax is a fixed charge that is more of a burden for SMEs than for large businesses.

The committee is proposing to substantially reduce the tax for SMEs—by nearly 40%—and thereby significantly narrow the gap in relation to the other provinces for all sectors of the economy.

By reducing the tax burden of SMEs, the lower payroll tax would both foster job creation and enhance the competitiveness of such enterprises on external markets by reducing their production costs.

The reduced payroll tax would benefit more than 200 000 entreprises.

☐ The tax burden differential

The tax burden differential represents the overall impact of taxation on all corporations. When the taxation system of the other provinces is applied to Québec corporations, we note that Québec's taxation system imposes on corporations a tax burden that is nearly double that in the other provinces.

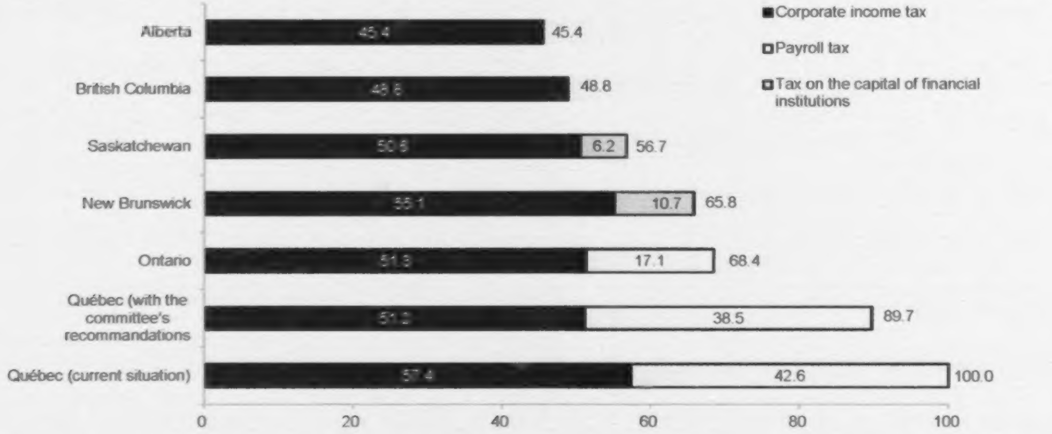
This difference represents a tax burden in excess of $2.8 billion in relation to the application in Québec of the Ontario tax regime. The difference stems by and large from the payroll tax.

The committee's recommendations would reduce by one-third the difference with Ontario.

The tax burden differential respecting corporate income tax, one of the taxes that is the most detrimental to economic growth, would be completely eliminated.

CHART 9

Tax burden differential – All corporations, 2014
(current Québec=100)



☐ The impact of the reform on investment decisions

The calculation of the marginal effective tax rate on capital is one recognized method of measuring and comparing the impact of taxation on business investment decisions.

The marginal effective tax rate on capital represents the portion of the return on an investment that is used to pay taxes. The lower the rate is, the higher the return net of tax on an investment will be.

In recent years, some experts[83] have shown that a taxation system that effectively fosters investment should limit as much as possible distortions between sectors. A disparity between the marginal effective tax rates on capital in different sectors can encourage investments in sectors with a lower return.

■ A comparable overall marginal effective tax rate on capital and fewer disparities between sectors

By combining the non-renewal of the investment tax credit with the reduction to 10% in the general tax rate, the marginal effective tax rate on capital in the manufacturing sector would stand at 10.9% and other sectors would benefit from a marginal effective tax rate reduced to 18.1%.

For the Québec economy overall, the rate would be 15.6%:

- a level comparable to that prior to the reform;
- a competitive level in relation to the other Canadian provinces.

What is more, most corporations would benefit from a lower marginal effective tax rate on capital that is closer to the Canadian average.

- Based on 2011 taxation data, only 5% of corporations operating in Québec are in the manufacturing sector.
- The investment tax credit now benefits roughly 4 000 entreprises; a reduction in the tax rate would benefit 90 000 firms.

The distortions in the taxation system would be reduced by the narrowing of the gap in the treatment of investments between economic sectors.

- The rate differential between the manufacturing sector and the rest of the Québec economy would fall by more than half, from 14.6 percentage points to 7.2 percentage points.

By reducing distortions on investment decisions, the committee's proposal would increase investments at a higher return for the economy.

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[83] Duanjie Chen and Jack Mintz, "2013 Annual Global Tax Competitiveness Ranking: Corporate Tax Policy At A Crossroads" in *SPP Research Papers*, Vol. 6, No. 35, The School of Public Policy, University of Calgary, November 2013.

TABLE 29

Marginal effective tax rate on capital in Québec, by sector

(as a percentage and in percentage points)

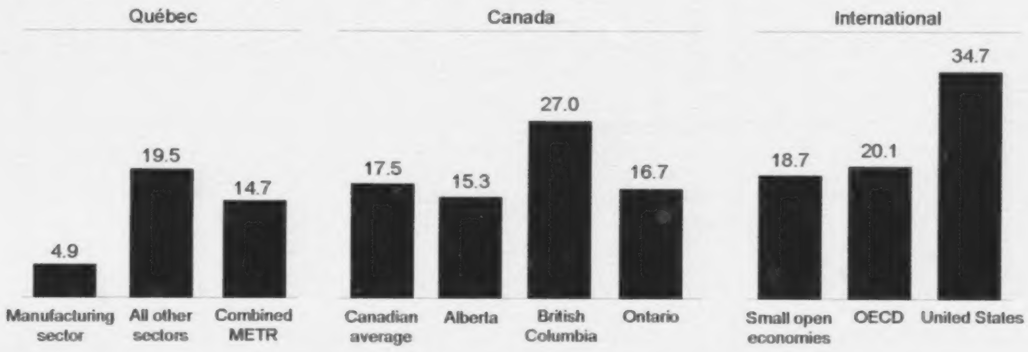
		With the investment tax credit		With the investment tax credit and at the 10% tax rate	
	Current rates	**Interest**	**Difference**	**Interest**	**Difference**
Manufacturing sector	4.9	12.0	+7.1	10.9	+6.0
Other sectors	19.5	19.5	—	18.1	−1.4
TOTAL	**14.7**	**16.9**	**+2.2**	**15.6**	**+0.9**

Note: Enterprises with assets of $15 million or more.

CHART 10

Marginal effective tax rates (METR) on capital taking into account the committee's recommendations

(as a percentage)



Note: For the other jurisdictions, 2014 is the reference year.

CONCLUSION

By establishing the Québec Taxation Review Committee, the Québec government sought to initiate thorough reflection on a tax reform that would make the taxation system more competitive, efficient and equitable.

At the conclusion of its eight months of deliberations, the committee is submitting to the government the outcome of its reflection.

☐ A major reform

The committee is proposing a new tax mix that consist in reducing personal income tax, corporate income tax and the payroll tax and in financing the reduction by means of lower tax expenditures and a new tax mix. The reform would be at zero cost for taxpayers and neutral for public finances.

In the medium and long term, the committee is formulating suggestions that should sustain future reflection by recommending a revision of the method of capital gains taxation and reflection on a dual income tax system.

The committee is convinced that the initiatives would directly, significantly affect economic growth and a higher standard of living.

The committee's proposed reform includes numerous other recommendations that target the objectives pinpointed. The committee believes that it is indeed possible to rely on taxation to promote business investments, encourage people to work, foster personal savings, engage in sustainable development and adapt the funding of public services to a changing society. It has formulated several proposals to this end.

In particular, it has focused on the collection by the government of all tax revenues. Moreover, it has ensured that the proposed reform would not call into question the equitable redistribution of collective wealth and adequate support for the most disadvantaged.

☐ Focusing on Québec's future

It is now incumbent upon the government to ensure the appropriate follow-up to the recommendations presented.

Through the proposed reform, the committee is proposing to rely on taxation to "focus on Québec's future."

RECOMMENDATIONS

Below are the recommendations that the committee has formulated in respect of each of the objectives adopted.

FIRST OBJECTIVE: FOSTER ECONOMIC GROWTH AND A HIGHER STANDARD OF LIVING

☐ A major tax reform

Recommendation 1

To foster economic growth and a higher standard of living, the committee is recommending that Québec undertake a major tax reform comprising three stages, each one corresponding to different time frames.

— In the **first stage**, in the short term, the committee recommends that the government lay the foundations of a tax regime more conducive to economic growth by **reducing** personal income tax, corporate income tax and the payroll tax **for the benefit of all taxpayers.** The reduction would be funded through **a reduction in tax expenditures** and **an adjustment of the methods of taxation**.

— In the **second stage**, in the medium term, the committee recommends that the government undertake **a review of the method of taxation in respect of capital gains** in order to define more coherent taxation.

— In the **third stage**, in the long term, the committee recommends that **thorough reflection occur on the very foundations of income tax** by **examining the implementation of a dual income tax system**.

First stage — A short-term initiative: a reduction of income tax, a review of tax expenditures and a new tax mix

☐ The proposed reform

Recommendation 2

The committee recommends the adjustment of methods of taxation leading to a **$5.9-billion** annual reduction in personal income tax, corporate income tax and the payroll tax:

- — a **$4.4-billion** reduction in personal income tax;
- — a **$1.1-billion** reduction in corporate income tax;
- — a **$430-million** reduction in the payroll tax.

Recommendation 3

The committee recommends that the reduction in personal income tax, corporate income tax and the payroll tax be funded, first, through the revision of tax expenditures and the elimination or tightening of a number of them.

- — The reduction in personal income tax would be funded through the revision of tax expenditures applicable to individuals and the revision of tax expenditures pertaining to consumption taxes.
- — The reduction in corporate income tax and the payroll tax would be funded through a revision of the tax expenditures applicable to corporations.

Recommendation 4

The committee recommends that the reduction in personal income tax, corporate income tax and the payroll tax also be funded through a new tax mix.

The committee adopted the following guidelines with respect to the methods of taxation:

- — shift part of the personal income tax burden to consumption taxes and user fees, bearing in mind, however, that income tax must predominate;
- — consider in the choice of taxation methods the need to ensure competitive taxation;
- — define the choices within the personal income tax system and the corporate income tax system.

Accordingly, the committee recommends avoiding choices that lead to the transfer of the tax burden between corporations and individuals.

❑ The introduction of the proposed reform: personal income tax

Recommendation 5

The committee recommends the elimination of the healthcare contribution, which would remove the inconsistencies observed in the marginal tax rates under the current system.

The abolition of the healthcare contribution alone would represent a **$734-million** personal income tax reduction.

Recommendation 6

The committee recommends that the basic personal amount be increased to $18 000.

The increase would benefit all taxable taxpayers and represent for them an annual gain of **$225 million**.

Recommendation 7

The committee recommends a general reduction in income tax, combined with a more progressive tax rate schedule.

The committee recommends that the number of brackets in the Québec tax rate schedule be increased to enhance the progressivity of personal income tax.

The number of rates in the tax rate schedule would increase from four to nine.

— Lower marginal rates would be reduced.

— The upper marginal rate would remain unchanged at 25.75% but would apply to a higher income.

The changes would represent an overall personal income tax cut of **$3.4 billion**.

Recommendation 8

The committee recommends that the maximum marginal tax rate of the personal income tax rate schedule, including federal taxation, not exceed 50%.

Recommendation 9

The committee recommends that the significant reduction in personal income tax be funded by means of:

- a revision of tax expenditures that would achieve more than **$1.010 billion** in net savings;
  - The committee is proposing an overall reduction in tax expenditures accompanied by the enhancement of a limited number of tax measures that satisfy the objectives adopted.
- broader recourse to consumption taxes, namely:
  - an increase in the rates that would generate **$2.665 billion** in additional tax revenues;
  - a revision of tax expenditures related to consumption taxes, representing savings of **$201 million**;
- additional reliance on user fees, namely:
  - **$101 million** in additional savings through the taxation of reduced-contribution childcare services rates,
  - an increase in the price of heritage pool electricity and a new tax on the overconsumption of electricity in the household sector, thereby generating **$705 million**.

Recommendation 10

The committee recommends a 1.025-percentage-point increase in the rate of the QST, from 9.975% to 11%. Combined with the GST, the rate would rise from 14.975% to 16%.

The increase would generate **$1.294 billion** in revenue.

Recommendation 11

The committee recommends that the rate of the tax on insurance premiums be harmonized with that of the QST and be set at 11%. Personal insurance premiums that are now exempt would continue to be so.

The increase would generate **$391 million** in revenue.

Recommendation 12

The committee recommends that the rate of the specific tax on tobacco products be increased in a predictable manner by $1 per year per carton for five years.

In the long run, the increase would generate **$160 million** in revenue.

Recommendation 13

The committee recommends that the tax on alcoholic beverages be increased by an additional $0.078 per litre of beer each year for five years, thereby ultimately generating annual revenues of **$210 million**.

Recommendation 14

The committee recommends that the fuel tax on gasoline and diesel be increased by 1 cent per litre per year for five years to send a clear signal to promote reduced consumption and to give taxpayers time to adapt.

The proposal would ultimately generate **$600 million** in tax revenues annually.

Recommendation 15

The committee recommends that the additional registration fee applied to luxury vehicles of more than $50 000 be increased and adjusted.

Accordingly, the rate, which is now 1% of the value that exceeds $40 000 of a vehicle:

— would remain 1% on the portion of the value exceeding $40 00 up to a maximum of $50 000;

— would rise to 2% on the portion of the value exceeding $50 000 up to a maximum of $60 000;

— would rise to 3% on the portion of the value exceeding $60 000.

The committee also recommends that electric vehicles no longer be subject to the additional fees in order to recognize their environmental benefits.

The proposal would generate **$11 million** in tax revenues annually.

Recommendation 16

The committee recommends that **$310 million** be earmarked to enhance the solidarity tax credit in order to protect the most disadvantaged against the deterioration of their financial situation that may stem from the new tax mix and the proposed tax increases.

This amount is added to the other measures that the committee is proposing that benefit the most disadvantaged, including:

— the increase in the basic personal amount;

— the reduction of the tax rates;

— the enhancement of the work premium that the committee is, moreover, recommending.

❑ The introduction of the proposed reform: corporate tax

Recommendation 17

The committee recommends reducing from 11.9% to 10% the corporate income tax rate.

The reduction of nearly 2 percentage points in the tax rate corresponds to a reduction of nearly 16% in the tax rate. The tax rate combined with the federal rate would, accordingly, stand at 25%.

The tax reduction would represent a **$675-million** gain for corporations.

Recommendation 18

The committee recommends the introduction of a “growth premium” for SMEs, which would replace the current small business deduction.

The premium would take the form of a tax credit or a deduction for private companies that reduces from 10% to 4% the tax rate on corporate income on the taxable income bracket between $100 000 and $500 000.

The new premium would encourage small enterprises to grow in order to reach levels of income that allow them to benefit from favourable tax treatment.

Eligibility for the new premium would be limited to Canadian-controlled private corporations with paid-up capital of less than $15 million, as is the case for the existing small business deduction.

What is more, access to the rate would be limited to corporations with at least five employees.

The “growth premium” would cost **$470 million**, i.e. $80 million less than the existing small business deduction.

Recommendation 19

The committee recommends reducing from 2.7% to 1.6% the rate of the payroll tax for SMEs, which would reduce their tax burden by **$430 million**.

Recommendation 20

The committee recommends that the reduction in corporate tax be funded by means of:

- a revision of tax expenditures from which businesses benefit, which would generate **$1.1 billion** in net savings:
  - the elimination of the full refundability of tax credits for large businesses, which, in the long run, would generate recurring savings of **$325 million**;
  - the elimination of the existing small business deduction, representing a recurring saving of **$550 million**, for a net saving of $80 million bearing in mind the new "growth premium;"
  - certain enhancements of tax measures concerning the cultural sector, estimated at **$5 million**;
  - the revision of other tax expenditures, which will generate additional savings of **$205 million**;
- broader recourse to user fees, i.e. an increase in the price of heritage pool electricity, which will generate **$500 million**.

Recommendation 21

From the standpoint of the revision of the tax expenditures from which corporations benefit, the committee recommends that the principle of refundability only be totally or partially maintained for Canadian-controlled private corporations with taxable income below $800 000 and whose worldwide paid-up capital does not exceed $50 million.

Furthermore, the committee recommends that the contributions to the Health Services Fund for all corporations be considered in the determination of the refundable portion of the tax credit, in addition to income tax.

This measure would generate recurring savings of **$325 million**.

It could be introduced gradually, over five years, to enable corporations to adapt to it.

Recommendation 22

Still on the theme of the revision of the tax expenditures from which corporations benefit, the committee has identified certain enhancements to the tax measures pertaining to the cultural sector, estimated at **$5 million**.

The committee also recommends that the possibility be examined of levying a tax on residential Internet services in order to support, in particular, the funding of existing tax measures or new culture-related measures.

Second stage — A medium-term perspective: a review of the taxation of capital gains

Recommendation 23

The committee recommends a comprehensive revision of the taxation of capital gains.

The revision would seek to treat more fairly capital gains compared with other sources of income.

— It would cover the medium term and require Canada-wide coordination to avoid capital gains realization simply shifting outside Québec were Québec to act alone.

— The revision would not be applied retroactively, i.e. it would not apply to capital gains prior to the implementation of the recommended reform.

Recommendation 24

The committee recommends the elimination of the partial inclusion of capital gains and its replacement by the recognition of the real capital gain, i.e. the capital gain that takes into account inflation. The capital gain would thus be taxed normally, like any other income.

— In the case of capital gains realized at the time of disposition of property owned for less than one year, the capital gain must be taxed like any other income.

— Beyond the one-year time limit, the capital gain realized would be adjusted to take into account inflation.

Such a medium-term change would require coordination between the other provinces and the federal government.

Recommendation 25

The committee recommends that specific treatment of the capital gain on principal residences be maintained.

However, the measure should be tightened in order to:

- exclude gains stemming from speculation;
- tax a portion of the gains stemming from stellar returns by limiting the exemption to an indexed lifetime amount of $1 million.

This is a medium-term change that would require coordination between the other provinces and the federal government.

Recommendation 26

The committee recommends that the existing lifetime capital gains exemption be replaced by an additional contribution to the registered retirement savings plan (RRSP) in order to directly foster saving for retirement.

This is a medium-term change that would require coordination between the other provinces and the federal government.

Recommendation 27

The committee recommends the abolition of the preferential treatment accorded stock options granted to employees.

This is a medium-term change that would require coordination between the other provinces and the federal government. In the short term, the committee is formulating other recommendations (Recommendation 41).

Third stage — Long-term reflection: the examination of a dual income tax system

Recommendation 28

To make income tax more favourable to economic growth and a higher standard of living, the committee recommends that Québec examine the implementation of a dual income tax system, following the example of the Scandinavian countries.

The committee wishes to emphasize that more detailed analyses should be conducted to determine whether this avenue is the one that should indeed be emphasized in the long term.

The collaboration of the other Canadian jurisdictions would, moreover, be essential.

SECOND OBJECTIVE: ENCOURAGE BUSINESS INVESTMENT

Recommendation 29

The committee recommends that the tax credit for the production of multimedia titles be enhanced to partly reverse the tightening measure adopted in June 2014. The Category 1 rate would increase from 24% to 28% and the Category 2 rate would rise from 21% to 25%. The rate of the French production premium eligible for Category 1 would be increased from 6% to 7%.

However, the committee recommends that the enhancement of the tax credit rate be accompanied by a ceiling on the tax credit equivalent to $25 000 per year per eligible job.

Recommendation 30

The committee recommends the maintenance as is of the existing tax credit for scientific research and experimental development and, more specifically:

- the maintenance at 14% of the rate of the scientific research and experimental development tax credit for large businesses;
- the maintenance at 30% of the rate of the scientific research and experimental development tax credit for SMEs;
- the introduction of budget measures to support the marketing by SMEs of the outcomes of research and development.

Recommendation 31

The committee recommends that the tax credit for the development of e-business be maintained until its scheduled expiry date on December 31, 2025 but that it not be renewed thereafter.

Recommendation 32

The committee recommends that that moratorium on the tax credit for the integration of IT in manufacturing SMEs be lifted.

Recommendation 33

The committee recommends the maintenance of the C2i tax holiday for major investment projects.

However, upon its scheduled expiry in 2015, the outcomes obtained should be examined to ascertain its genuine impact and use before it is extended.

Recommendation 34

The committee recommends the immediate abolition of the basic investment tax credit applicable to the central regions.

For the regions eligible for the enhanced rate—remote and intermediate regions—the committee recommends the complete abolition in 2018. Until the tax credit's abolition, the rate applicable in these regions would be adjusted according to the immediate abolition of the tax credit for central regions.

Recommendation 35

The committee recommends that, as planned, the rate of the tax credit applicable to purchases of shares in the Fonds de solidarité FTQ and Fondaction be standardized at 15%.

Recommendation 36

The committee recommends that the rate of the tax credit applicable to purchases of shares in the Fonds Capital régional et coopératif Desjardins be reduced from 45% to 25%.

Recommendation 37

The committee recommends that the minimal proportion of eligible investments that the three tax-advantaged funds must make in Québec SMEs—the "investment standard"—be raised from 60% to 70%.

To give the funds the means to abide by the new standard, no ceiling on annual issues would be imposed on the labour-sponsored funds. In the case of the Fonds Capital régional et coopératif Desjardins, the total capitalization ceiling of $1.25 billion would be abolished and the fund could issue $150 million annually.

Recommendation 38

To afford the three tax-advantaged funds greater leeway in their investment decisions, the committee recommends that the government increase the minimum holding period for shares.

- The holding period for the two labour-sponsored funds would be increased from two years to five years.
- In the case of the Fonds Capital régional et coopératif Desjardins, it would be increased from seven years to 10 years.

Recommendation 39

To stimulate investments by facilitating business transfers between persons dealing on a non-arm's length basis, the committee has identified three solutions that it recommends the government contemplate.

- The first solution would consist in reaching agreement with the federal government such that the sales of businesses by parents to their children through a corporation be eligible for the capital gains exemption under certain specific conditions.
- Under the second solution, Québec would intervene independently of the federal government and would remedy the situation solely in respect of Québec tax, under specific conditions.
- As for the third solution, Québec would accord all businesses the treatment now allowed agricultural enterprises or fishing businesses. Its application beyond agricultural enterprises or fishing businesses would require consultation with the federal government.

In all of the solutions identified, the committee is insisting on the importance of defining the specific tax rules for transactions genuinely related to family business successions.

Recommendation 40

In the case of the capital gains exemption for the sale of agricultural land, the committee recommends the elimination of the eligibility of farm property once it is no longer used for agricultural purposes.

Recommendation 41

In the absence of agreement between all of the provincial governments concerning the abolition of the preferential treatment accorded stock options granted to employees, the committee is making the following recommendation.

In the case of public business corporations, the committee recognizes that the tax treatment of stock options is at the very root of the reasons that led to their implementation. In the current context, the committee recommends that Québec harmonize its provisions with those in force elsewhere in Canada to avoid its high-income earners from moving to the other provinces.

As for private corporations, the committee recommends the maintenance of the current treatment.

THIRD OBJECTIVE: ENCOURAGE LABOUR MARKET PARTICIPATION

Recommendation 42

To tackle the problem of high implicit marginal tax rates, the committee recommends the establishment of a “tax shield” intended to reduce the implicit marginal tax rate tied to an annual increase in income.

The “tax shield” would take the form of a deduction of 50% of the increase in work income up to a maximum increase of $5 000 per household and would apply to net income, thus creating a “net adjusted income,” used to calculate the following socio-fiscal tax credits:

- the work premium, including its enhancement and the new premium for experienced workers that the committee is recommending;
- the solidarity tax credit;
- the tax credit for childcare expenses.

The measure would cost **$90 million**.

Recommendation 43

To promote the maintenance on or a return to the labour market by workers approaching retirement or who have already retired, the committee recommends the replacement of the tax credit for experienced workers by a premium for experienced workers to be added to the work premium.

The premium would apply to work income exceeding $5 000 up to a maximum surplus income of $10 000.

The tax credit would be available at the age of 60. The rate of the tax credit would be 15% starting at the age of 60 and up to the age of 64 for a maximum tax credit of $1 500. The rate would increase to 25% starting at the age of 65, for a maximum tax credit of $2 500.

Starting with work income of $30 000, the maximum amount would be reduced by 10% for each additional dollar of work income.

The measure would have a total annual cost of **$335 million**. Bearing in mind the cost of the tax credit for experienced workers that it is replacing, the net cost of the measure would be $275 million.

Recommendation 44

To further reward the work effort and bolster incentives to integrate the labour market, the committee recommends the enhancement of the work premium.

The supplementation rate of the work premium for households without serious employment limitations would be increased by 2 percentage points for childless households and by 2.5 percentage points for households with children. The supplementation rates for work income would thus be 9% for persons living alone and childless couples, 27.5% for couples with children, and 32.5% for a single-parent family.

A similar enhancement of the supplementation rate would be applied to a household in which there is one adult with serious employment limitations.

The work premium would continue to be reducible according to family income subject to a benefit recapture rate of 10% for each dollar of income that exceeds the applicable income threshold, depending on the type of household. The reduction points would remain the same.

This recommendation would have a total cost of **$107 million**.

Recommendation 45

In conjunction with the enhancement of the work premium, the committee recommends that the income thresholds at which the tax credit for child assistance becomes reducible according to income be increased from $34 280 to $36 273 for a single-parent family and from $47 196 to $50 310 for a couple with children.

In addition to this change, the committee recommends that the clawback rate on the amounts paid pursuant to the refundable tax credit for child assistance decrease from 4% to 3%.

Moreover, the committee recommends that the universal portion of the credit be eliminated. Couples with two children and incomes of nearly $170 000 would no longer receive any amount under the tax credit for child assistance.

The recommendation would have a net cost of **$6 million**.

Recommendation 46

The committee recommends that the Québec government not harmonize itself with the federal household income-splitting measure.

FOURTH OBJECTIVE: ENCOURAGE PERSONAL SAVINGS

See also recommendation 26 and recommendations 35 to 38

Recommendation 47

To ensure that funds saved in an RRSP are used, first and foremost, for retirement, the committee recommends that a penalty of up to 10% be levied when funds are withdrawn from an RRSP before the age of 55, except under certain specific circumstances.

The committee also recommends that the deduction at source be changed to the maximum tax rate for any withdrawal before the age of 55 in order to discourage such withdrawals.

Recommendation 48

The committee recommends that Québec, in collaboration with the federal government and the provinces, engage in reflection to better match the RRSP and the TFSA and thereby enhance the overall coherence of saving incentives.

FIFTH OBJECTIVE: ADHERE TO SUSTAINABLE DEVELOPMENT

See also recommendations 14 and 15

Recommendation 49

The committee recommends that the cost of heritage pool electricity be increased by 0.8 cent per kilowatt-hour over two years and that its indexation be maintained subsequently.

The additional revenues generated by the increase would be used to fund the committee's proposed tax reform by using the funds generated for individuals and corporations, respectively.

The revenues stemming from the indexation would continue to be paid into the Generations Fund.

This measure would generate total annual revenues of **$1.123 billion**:

— **$623 million** among individual consumers;

— **$500 million** among corporations.

Recommendation 50

The committee recommends that a 10% tax be levied on overconsumption of average household electricity exceeding 80 kilowatt-hours per day.

The measure would generate **$82 million** annually.

Recommendation 51

The committee recommends that Québec better integrate the principles of sustainable development through eco-taxation and the application of the user pay principle or the polluter pays principle.

To this end, the committee recommends that the government closely monitor research and experience in the realm of eco-taxation both abroad and in Canada and Québec to collect as much information as possible to maximize the benefits that Québec society could derive from such taxation.

SIXTH OBJECTIVE: COLLECT ALL TAX REVENUES

The fight against tax evasion, tax avoidance and aggressive tax planning schemes

Recommendation 52

Bearing in mind the initiatives already undertaken, the committee recommends that Québec pursue the fight against tax evasion, tax avoidance and aggressive tax planning schemes.

Recommendation 53

The committee recommends that the Québec government step up discussions with the other provinces and the federal government in order to further promote collaboration between the different jurisdictions.

In practical terms, this question should be put on the agenda of interprovincial or federal-provincial meetings, for example within the framework of the finance ministers' conferences or the Council of the Federation.

Recommendation 54

The committee believes that the Québec government must clearly indicate its concern about the fight against tax evasion, tax avoidance and aggressive tax planning schemes.

Québec should vigorously support international efforts to fight against tax evasion, tax avoidance and aggressive tax planning schemes.

The committee recommends that Québec establish a centre of expertise devoted to the fight against tax evasion, tax avoidance and aggressive tax planning schemes. Such an initiative is one means of playing a leading role in the fight.

The committee also recommends that the federal government be asked to inform the provinces and the public of the extent of the problem and the solutions that it is implementing or intends to implement.

Recommendation 55

The committee recommends that simple initiatives be implemented to ensure better follow-up to the processing of taxpayers' files during an audit.

- The committee is referring, in particular, to the numbering of proposed assessments, which would make it possible to more readily track the advancement of taxpayers' files.
- The committee also recommends that the government evaluate the establishment of a dispute settlement mechanism.
- Furthermore, an evaluation of customer service should be conducted after each audit.
- Lastly, Revenu Québec should maintain public statistics concerning the proportion of new assessment notices that are maintained following an appeal or litigation.

The collection of sales tax and income tax pertaining to e-commerce

Recommendation 56

With regard to e-commerce, the committee recommends that the Québec government initiate discussions to obtain the federal government's consent to administer, on behalf of the Québec government, the registrations that would become compulsory under the QST regime for businesses located outside Québec that make supplies to Québec without maintaining there a physical or significant presence.

Recommendation 57

In the case of the collection of sales taxes on online transactions conducted by suppliers from foreign countries, the committee recommends that the Québec government pressure the federal government to step up its efforts within the framework of the OECD's ongoing deliberations.

Recommendation 58

The committee is of the opinion that the Québec government should assume leadership among the Canadian provinces overall with respect to the collection of the sales tax linked to e-commerce conducted with the rest of Canada and foreign countries.

Recommendation 59

The committee recommends that the Québec government pressure the federal government to step up its efforts within the framework of the OECD's ongoing deliberations with respect to the collection of corporate income tax linked to e-commerce and the collection of sales taxes on transactions carried out with foreign countries by means of e-commerce.

Better oversight of provisions respecting trusts

Recommendation 60

To put an end to the worrisome situations that stem from the use of trusts to shift the tax outside Québec, the committee recommends that the Québec government initiate discussions with the federal government and the provinces:

- — to agree to amend the tax provision stipulating that the income payable by a trust to its beneficiaries be deemed, almost without exception, to be income from property;
- — so that property income from the rental of certain buildings and the capital gains from their disposition be subject to income tax according to the location of the buildings rather than the residency of the trust.

Should the discussions with the federal government and the provinces fail to produce the desired results, the committee recommends that the Québec government contemplate the possibility of acting unilaterally in order to make liable for tax income from a business operated in Québec and rental income from a building located in Québec. Québec could grant a tax credit to offset the tax collected by another province.

Recommendation 61

As for the use of trusts to circumvent the concept of associated companies, the Québec government has already adopted, under certain circumstances, provisions that stipulate that the trust is deemed to be a corporation for the application of the association rules the beneficiaries of the trust are deemed to be shareholders of the corporation.

The committee recommends that similar provisions be adopted to interpret the concepts of "non-arm's-length relationships," "associated companies" and "related persons" when a trust is used within a corporate group.

Recommendation 62

The committee recommends that the government initiate discussions with the federal government to amend the rules in force concerning income-splitting and, more specifically, the concept of split income.

The committee is proposing to extend the tax on split income for minor children to children of legal age and the spouse, with the exception of those among them who participate in the company's activities.

Making such taxpayers liable for the tax on split income would significantly reduce certain types of planning schemes that rely on income-splitting.

Recommendation 63

The committee recommends that the government initiate discussions with the federal government to limit certain planning schemes concerning the lifetime capital gains exemption.

Accordingly, the committee is proposing that a minor child no longer be allowed to benefit from the lifetime capital gains exemption when shares are transferred to a person with whom the minor child has no arm's length relationship in order to limit the attendance tax planning schemes.

Moreover, the lifetime capital gains exemption should only be available to children of legal age and the spouse who participate in the activities of a family business.

SEVENTH OBJECTIVE: ADAPT TAXATION TO A CHANGING SOCIETY

User fees for reduced-contribution childcare services

Recommendation 64

The committee recommends a revision of the method of funding reduced-contribution childcare services through the taxation of a single rate. The revision is intended, above all, to ensure the long-term survival of the reduced-contribution childcare services network.

The committee has thus ensured in the definition of its proposal that it is not raising the cost of childcare services for most families in relation to funding at $7.30 a day and, indeed, that it is reducing it for low- or middle-income households.

In its scenario, the committee is proposing to:

- set the gross rate, before tax compensation, at $35 per day;
- make the rate eligible for the Québec refundable tax credit for childcare expenses, which would be enhanced;
- subsequently index the rate annually.

The advance payment of the tax credit for childcare expenses should, what is more, be adapted to ensure that all families affected by the change may take advantage of it as soon as it comes into force.

The committee also recommends the application to school childcare services of a revision concerning the principle of taxation but adapted to the specific nature of such services.

The sound management of tax expenditures

Recommendation 65

The government has indicated its determination to apply an arbitration mechanism also called the "safety catch" to budgetary expenditure. The committee recommends that the same logic be applied to tax expenditures.

This stringent control would ensure that new tax expenditures cannot be implemented unless tax expenditures of an equivalent scope are simultaneously eliminated.

Recommendation 66

The committee recommends that tax expenditures be subject to periodic evaluation.

The periodic evaluation framework would apply to all tax expenditures.

The framework adopted would specify the prescribed time limit within which a re-evaluation must be conducted, e.g. within five years.

Recommendation 67

The committee recommends that accountability respecting tax expenditures be integrated into the budget documents tabled in the National Assembly.

Recommendation 68

To enhance budget transparency, the committee recommends that the list of corporations that obtain refundable tax credits, beyond a certain threshold, be published, and the amounts in question.

Recommendation 69

The committee recommends that the question of interprovincial tax competition be put on the agenda of interprovincial or federal-provincial meetings, for example within the framework of the finance ministers' conferences or the Council of the Federation.

EIGHTH OBJECTIVE: ENSURE THE EQUITABLE REDISTRIBUTION OF COLLECTIVE WEALTH AND ADEQUATE SUPPORT FOR THE MOST DISADVANTAGED

See also recommendations 6, 7 and 44

Recommendation 70

To protect the most disadvantaged against the deterioration of their financial situation that may result from the proposed new mix of taxes, the committee is proposing a $310-million enhancement of the parameters of the solidarity tax credit.

The committee recommends increases of:

- $75 of the base amount, i.e. a 27% enhancement in relation to the current base amount of $278;
- $75 of the spousal amount, i.e. a 27% enhancement in relation to the current spousal amount of $278;
- $50 of the additional amount for a person living alone, i.e. a 38% enhancement in relation to the current additional amount for a person living alone of $133.

Recommendation 71

From the standpoint of the management of the solidarity tax credit, the committee recommends that the appropriate means be adopted to tackle the significant shortcomings identified recently.

APPENDIX 1: THE QUÉBEC TAXATION REVIEW COMMITTEE

❑ Committee members

Luc Godbout, chair, is the Director of the Département de fiscalité at the Université de Sherbrooke and principal investigator in public finances of the Research Chair in Taxation and Public Finance. His recent research has focused on the tax structure and the consequences of the ageing of the population on public finances and funding for public pension plans.

Dana Ades-Landy is Vice-President of Scotia Bank and President of the Board of the Association of Quebec Women in Finance. She has also worked at Laurentian Bank of Canada and National Bank of Canada.

Pierre-Carl Michaud is associate professor in the Département des sciences économiques at the Université du Québec à Montréal and holds the Industrial Alliance Research Chair on the Economics of Demographic Change. He specializes in economic questions related to the ageing of the population such as preparation for retirement and health.

Danièle Milette, a tax expert, was a partner at Deloitte from 2007 to May 2014 and specializes in taxation services for SMEs. Throughout her career she has participated in several committees of the Association de planification fiscale et financière.

Yves St-Maurice is an economist and was formerly senior director and assistant chief economist with the Fédération des caisses Desjardins du Québec. He has also worked as senior economist and associate director of the Conference Board of Canada.

Jean-Pierre Vidal, CPA, CA, associate professor of taxation, HEC Montréal, specializes in international taxation, ethics in taxation and taxation research methodology.

Luc Villeneuve, FCPA, FCA, has been Chairman for Québec of Deloitte since 2009. He has been with the organization since 1974 and has occupied a number of strategic positions, including in the audit department. Moreover, in 2012-2013 he served as president of the Fédération des chambres de commerce du Québec and was president of the Institut des administrateurs de sociétés du Québec from 2007 to 2009.

Carole Vincent is an economist, consultant and researcher in economics. She has worked for several years in research organizations and has extensive experience in the realm of the evaluation of public policies, in particular the personal income tax system and labour force participation.

APPENDIX 2: THE COMMITTEE'S PUBLIC CONSULTATIONS

1. CITIZENS' FORUMS

- September 29, 2014: Lévis
- October 1, 2014: Sherbrooke
- October 2, 2014: Montréal
- October 6, 2014: Gatineau
- October 7, 2014: Rouyn-Noranda
- October 8, 2014: Saguenay
- October 9, 2014: Rimouski

2. INTERVENERS WITH WHOM THE COMMITTEE MET DURING THE PUBLIC HEARINGS

Montréal

October 20, 2014:

- — Alliance numérique
- — Jeux WB Montréal
- — Techno Montréal
- — Les sociétés de recherche sous contrat
- — Regroupement des producteurs multimédias
- — FRAPRU
- — Coalition régionale des étudiants de Montréal
- — Chantier de l'économie sociale
- — Écotech
- — Université de Montréal
- — FECQ
- — Fédération des chambres de commerce du Québec

October 21, 2014:

- — Fondation CSN
- — CRCD
- — FIERA Capital
- — Réseau Capital.
- — Fédération canadienne de l'entreprise indépendante
- — APCHQ
- — Office des personnes handicapées du Québec
- — Association québécoise des CPE
- — Ordre des CPA
- — Vivian Labrie
- — IREC
- — Association professionnelle des conseillers en services financiers
- — Association québécoise pour la taxation des transactions financières et pour l'action citoyenne

October 22, 2014:

— Ville de Montréal et Communauté métropolitaine de Montréal

— Association de médiation fiscale

— Société de transport de Montréal

— Aéro Montréal

— CQCD

— Manufacturiers et exportateurs du Québec

— Juste pour rire

— CPQ

— Montréal International

— Chambre de commerce de Montréal métropolitain

— Brigitte Alepin

October 23, 2014:

— Quebecor Média, Groupe TVA, Groupe Archambault et Groupe Sogides inc.

— Association nationale des éditeurs de livres

— Association québécoise de la production médiatique

— Alliance québécoise des techniciens de l'image et du son (AQTIS), ARRQ, UDA, SARTEC, GMMQ et SPACQ

— Alliance Québec Animation

— Association DOC Québec

— Guilde canadienne des réalisateurs du Québec

— Union des artistes

— Association nationale des doubleurs professionnels

— Association québécoise de l'industrie du disque, du spectacle et de la vidéo

— Regroupement des producteurs de cinéma du Québec

— Conseil québécois de la production de langue anglaise (Quebec English-Language Production Council)

— Coalition de 12 sociétés du secteur des effets visuels au Québec

— Alliance internationale des employés de scène, de théâtre, des techniciens de l'image, des artistes et des métiers connexes des États-Unis, ses territoires et du Canada

24 octobre 2014 (proceeding in camera):

- Bombardier
- Centre québécois de formation en fiscalité
- CGI
- EEDAE
- Technicolor
- UBISOFT
- Moment Factory

Québec City

October 28, 2014:

- Association de l'exploration minière du Québec
- Fédération des producteurs forestiers québécois
- Pétrolia
- FTQ
- CSQ
- CSN
- SPGQ
- Fédération québécoise des municipalités
- Fonds de solidarité FTQ

October 29, 2014:

- Corporation des propriétaires immobiliers du Québec (CORPIQ)
- UPA
- Association des restaurateurs du Québec
- AQESSS
- Coalition québécoise pour le contrôle du tabac
- Coalition québécoise sur la problématique du poids
- FEUQ
- CADEUL
- Association canadienne des compagnies d'assurances de personnes
- Association des économistes québécois
- Coalition des tables régionales d'organismes communautaires et de la Table des regroupements provinciaux d'organismes communautaires et bénévoles

October 30, 2014:

- Association canadienne de la technologie de l'information
- Association des producteurs de théâtre privé
- Association québécoise des technologies
- SWITCH
- Montréal In Vivo
- C2MI
- Conseil québécois de la coopération de la mutualité
- Union des municipalités du Québec
- Collectif pour un Québec sans pauvreté
- Chantier Davie
- Table maricole du Québec
- Association des distillateurs canadiens

3. INTERVENERS THAT SUBMITTED BRIEFS

— Aéro Montréal

— AGORA Fiscalité Inc.

— Alain Pelletier

— Alliance internationale des employés de scène, de théâtre, des techniciens de l'image, des artistes et des métiers connexes des États-Unis, ses territoires et du Canada (AIEST)

— Alliance numérique

— Alliance Québec Animation (AQA)

— Alliance québécoise des techniciens de l'image et du son (AQTIS) & ARRQ, UDA, SARTEC, GMMQ, SPACQ

— André Huot

— Anges Québec

— AREQ (CSQ), Association des retraitées et retraités de l'éducation et des autres services publics du Québec

— Association canadienne de l'enseignement coopératif, comité Québec (ACDEC-Québec) en collaboration avec le Service des stages et du placement de l'Université de Sherbrooke

— Association canadienne de la technologie de l'information (ACTI)

— Association canadienne des compagnies d'assurances de personnes (ACCAP)

— Association canadienne du logiciel de divertissement (ACLD)

— Association de l'exploration minière du Québec (AEMQ)

— Association de médiation fiscale

— Association de planification fiscale et financière (APFF)

— Association des distillateurs canadiens

— Association des économistes québécois (ASDEQ)

— Association des haltes-garderies communautaires du Québec (AHGCQ)

— Association des producteurs de théâtre privé (APTP)

— Association des professionnels de la construction et de l'habitation du Québec (APCHQ)

— Association des Propriétaires Fonciers du Québec

— Association des restaurateurs du Québec (ARQ)

— Association DOC Québec

— Association minière du Québec (AMQ)

— Association nationale des Doubleurs Professionnels (ANDP)

— Association nationale des éditeurs de livres (ANEL)

- Association pour la Protection des Intérêts des Consommateurs de la Côte-Nord (l'APIC)
- Association pour la Taxation des Transactions financières et pour l'Action Citoyenne (ATTAC-Québec)
- Association pour le développement de la recherche et de l'innovation du Québec (ADRIQ)
- Association Professionnelle des Conseillers en Services Financiers (APCSF)
- Association québécoise de l'industrie de la pêche (AQIP)
- Association québécoise de la production médiatique (AQPM)
- Association québécoise de l'industrie du disque, du spectacle et de la vidéo (ADISQ)
- Association québécoise des CPE (AQCPE)
- Association québécoise des technologies (AQT)
- Association québécoise d'établissements de santé et de services sociaux (AQESSS)
- Bastien Deschênes
- Benoit Laflamme et Dominique Leblanc
- Benoit Lavigne
- Bobby Tremblay
- Bombardier Inc. et Pratt & Whitney Canada Cie
- Canada Film Capital Corporation
- Capital régional et coopératif Desjardins (CRCD)
- Cédric Gaulin & associées
- Central des syndicats du Québec (CSQ)
- Centre de Collaboration MiQro Innovation (C2MI)
- Centre québécois de formation en fiscalité (CQFF)
- Chambre de commerce du Montréal métropolitain (CCMM)
- Chantier Davie Canada Inc.
- Chantier de l'économie sociale
- Christian
- Claude Joly
- Claude Samson
- CLD de Marguerite-D'Youville
- Coalition Avenir Québec (CAQ)
- Coalition nationale contre le tabac de contrebande (CNCTC)
- Coalition opposée à la tarification et à la privatisation des services publics

- Coalition québécoise pour le contrôle du tabac
- Coalition québécoise sur la problématique du poids (CQPP)
- Coalition régionale des étudiants de Montréal (CREM)
- Collectif Échec aux paradis fiscaux
- Collectif pour un Québec sans pauvreté
- Comité sur l'avenir industriel
- Commission des droits de la personne et des droits de la jeunesse (CDPDJ)
- Communauté métropolitaine de Montréal (CMM)
- Confédération des associations d'étudiants et étudiantes de l'Université LAVAL (CADEUL)
- Confédération des organismes de personnes handicapées du Québec (COPHAN)
- Confédération des syndicats nationaux (CSN)
- Conférence régionale des élus (CRÉ) de l'Abitibi-Témiscamingue
- Conseil du patronat du Québec (CPQ)
- Conseil québécois de la coopération et de la mutualité (CQCM)
- Conseil québécois de la production de langue anglaise (Quebec English-language Production Council - QEPC)
- Conseil québécois des services de garde éducatifs à l'enfance (CQSGEE)
- Conseil québécois du commerce de détail (CQCD)
- Corporation des propriétaires immobiliers du Québec (CORPIQ)
- COTE 100
- Cuisines collectives des Bois-Francs (CCBF)
- Culture Montréal
- Daniel Boisvert
- Daniel DiQuinzio
- Denis Trottier
- ÉCOTECH
- Ericsson
- Fédération canadienne de l'entreprise indépendante (FCEI)
- Fédération des associations de familles monoparentales et recomposées du Québec (FAFMRQ)
- Fédération des Associations étudiantes universitaires québécoises en éducation permanente (FAEUQEP)
- Fédération des chambres de commerce du Québec (FCCQ)

— Fédération des producteurs forestiers du Québec (FPFQ)

— Fédération des propriétaires de bois du Québec

— Fédération des travailleurs et travailleuses du Québec (FTQ)

— Fédération étudiante collégiale du Québec (FECQ)

— Fédération étudiante universitaire du Québec (FEUQ)

— Fédération québécoise des municipalités (FQM)

— FIERA Capital

— Finance Montréal

— Fondaction CSN

— Fonds de solidarité FTQ

— France Reny

— François Beaulieu

— Front commun des personnes assistées sociales du Québec (FCPASQ)

— Front d'action populaire en réaménagement urbain (FRAPRU)

— Gilles Ragault

— Groupe Bouffard

— Groupe CGI Inc.

— Guilde canadienne des réalisateurs du Québec (DGCQC)

— Guilde des musiciens et musiciennes du Québec (GMMQ)

— Hervé Anctil

— Impérial Tobacco Canada

— Institut de recherche en économie contemporaine (IRÉC)

— Institut de recherche et d'informations socio-économiques (IRIS)

— Jean Linteau

— Jean-Claude Tanguay

— Jean-François Robert

— Jean-Pierre Aubry

— Julien Lacombe

— Juste Pour Rire

— Kaïbou Production Inc.

— La Boîte à Fanny Inc.

— LASTUSE du Saguenay

— Laurier Saint-Amant

— Lise et Paul Fréchette

— Lisette Boivin

— Louis Dion

— Manufacturiers et Exportateurs du Québec (MEQ)

— Marc Nadeau

— Marc-André Adam

— MESS, Comité consultatif de lutte contre la pauvreté et l'exclusion sociale (CCLPES)

— Moment Factory

— Montréal In Vivo

— Montréal International

— Nick Maltais

— Nicolas Royer

— Normand Ryan Tremblay

— Northforge

— Office des personnes handicapées du Québec (OPHQ)

— Olivier Brabant, LL.M. Fisc.

— Olivier Jacques et Alain Noël

— Ordre des CPA

— Organisation d'Aide aux Sans-emploi (ODAS - Montréal)

— Patrick D'astous

— Paul Fortin

— Peter Dietsch et Jocelyn Maclure

— PÉTROLIA INC

— Pierre Chaigneau

— Pierre Laval Mathieu

— Pierre Pontbriand

— Pierre-Hugues Vallée

— Pierre-Luc Mathieu

— Projet Genèse

- PwC
- Québécor Média - Groupe TVA
- Québécor Média Inc. - Groupe Archambault
- Québécor Média Inc. - Groupe Sogides inc.
- Raoul J. Pettigrew
- Récif02 Table de concertation des groupes de femmes Saguenay-Lac-Saint-Jean
- Regroupement des assistées sociales et assistés sociaux du Témiscouata (RASST)
- Regroupement des Entreprises engagées en développement des affaires électroniques (EEDAE)
- Regroupement des organismes d'éducation populaire autonome de la Mauricie (ROM)
- Regroupement des partenaires du gouvernement en technologie de l'information (RPGTI)
- Regroupement des producteurs indépendants de cinéma du Québec (RPICQ)
- Regroupement des producteurs multimédias (RPM)
- Regroupement national des conseils régionaux de l'environnement (RNCREQ)
- Réjean Tremblay
- Réseau Capital
- Richter
- Robert Larouche
- Roland Pépin
- Simon Carmichael
- Société de transport de Montréal (STM)
- Sociétés de recherche sous contrat (SRC)
- Spiegel Sohmer
- SWITCH
- Syndicat de professionnelles et professionnels du Gouvernement du Québec (SPGQ)
- Table d'action contre l'appauvrissement de l'Estrie (TACAE)
- Table des Groupes Populaires, Michel Savard, membre du MÉPACQ
- Table des regroupements provinciaux d'organismes communautaires et bénévoles
- Table maricole du Québec et du secteur de la mariculture québécoise
- TAXCOOP CONFERENCE
- Technicolor
- Techno Montréal

— Transfilm International Inc.

— Ubisoft

— Union des artistes (UDA)

— Union des municipalités du Québec (UMQ)

— Union des producteurs agricoles (UPA)

— Universitas

— Vérificateur général du Québec

— Ville de Gatineau

— Ville de Montréal

— Vivian Labrie

— Vivre en ville

— Warner Bros. Games Montréal

— Yvon Robert

— Anonymous 1

— Anonymous 2

— Anonymous 3

APPENDIX 3: THE STUDIES AND REPORT UNDERPINNING THE COMMITTEE'S DELIBERATIONS

☐ Studies

Julies Ades *et al. Fiscalité et aide publique aux entreprises : Revue de la littérature et analyse*, Institut du Québec, November 2014.

Brigitte Alepin, summary of the lecture entitled *"The Impact of Globalisation on Taxation"* delivered on behalf of the Québec Taxation Review Committee, Agora Fiscalité, November 2014.

Alain Charlet and Stéphane Buydens, *L'expérience internationale et les tendances actuelles en matière d'impôt sur la consommation*, November 2014.

Jean-Pierre Duclos *et al. La fiscalité québécoise et l'incitation au travail,* Industrial Alliance Research Chair on the Economics of Demographic Change, December 2014

E&B Data, *Revue des programmes de crédits d'impôt à la Nouvelle Économie*, December 2014.

International Monetary Fund. *Tendances récentes et perspectives dans les réformes de l'imposition directe – Note technique préparée à l'intention de la Commission d'examen sur la fiscalité québécoise*, Department of Public Finance, November 2014.

Luc Gagnon, Jean-François Lefebvre and Jonathan Théorêt in collaboration with Réjean Benoit and Michelle Craig, *Modalités et avantages d'une réforme fiscale écologique pour le Québec : Mythes, réalités, scénarios et obstacles*, [report], Groupe de recherche appliquée en macroécologie, November 2014.

Jonathan Rhys Kesselman, *La fiscalité et l'incitation à l'épargne des ménages québécois – Document à l'intention de la Commission d'examen sur la fiscalité québécoise*, November 2014.

Gilles N. Larin, Lyne Latulippe and Marwah Rizqy in collaboration with Carmina Chan, *La fiscalité international et interprovincial au Québec*, study produced for the Québec Taxation Review Committee, Research Chair in Taxation and Public Finance, Université de Sherbrooke, November 2014.

Claude Montmarquette, Matthieu Strub and Louis Lévy-Garboua, *La tarification des services publics : un mode de financement à privilégier au Québec – Rapport de projet, CIRANO,* November 2014.

Pierre-Olivier Pineau, *L'électricité au Québec : Faire entrer le secteur dans le 21^{e} siècle – Rapport soumis à la Commission d'examen de la fiscalité québécoise*, Chaire de gestion du secteur de l'énergie, HEC Montréal, October 2014.

Ebrahimi Pouya, Marylène Roy and François Vaillancourt, *L'incidence de l'impôt sur les bénéfices des taxes sur la masse salariale et des taxes générales sur les transactions : revue des écrits et résultats pour le Canada, 2000-2012 – Rapport de projet*, CIRANO, November 2014.

Raymond Chabot Grant Thornton, *Les mesures favorisant l'investissement au Québec – Analyse comparative des pratiques autour du globe*, November 2014.

KPMG, *Le soutien fiscal à la R-D au Québec – État des lieux et analyses comparatives avec d'autres territoires*, December 2014.

KPMG, *Analyse des mesures fiscales destinées aux entreprises du secteur culturel*, November 2014.

Suzie St-Cerny, *La fiscalité québécoise et l'utilisation des mesures fiscales destinées aux particuliers – Étude préparée pour la Commission d'examen de la fiscalité québécoise,* Research Chair in Taxation and Public Finance, Université de Sherbrooke, October 2014.

Jean-François Wen, Bev Dahlby amd Ergete Ferede, *Les implications des distorsions fiscales sur la réforme fiscale au Québec,* Novembver 2014.

☐ Report of the Institut du Nouveau Monde on the public consultations

Institut du Nouveau Monde, *Forums citoyens sur la fiscalité québécoise – Rapport final présenté à la Commission d'examen de la fiscalité québécoise*, December 1, 2014.

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